A STUDY TO DEVELOP GUIDELINES FOR IMPLEMENTATION OF
FLEXIBLE COMPENSATION FOR NONEXEMPT EMPLOYEES

DISSERTATION

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By

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Flexible compensation is a new concept in wage and salary administration which permits the employee to select from the various benefits, and cash, a plan tailored to meet his own needs, limited only by his total compensation and those statutory provisions pertaining to his wages. Within recent years, compensation practitioners have been urged in professional journals to adopt flexible compensation as a way to improve their compensation programs in order to attract, hold, and motivate employees.

The purpose of this study is twofold. First, the results of this research will provide empirical data on the current status of flexible compensation for nonexempt employees in the United States. Second, the research will contribute toward the development of a set of comprehensive guidelines for implementing flexible compensation programs.

A questionnaire was developed, pretested, and mailed to 668 compensation managers, or compensation specialists, representing 666 firms having membership in the American Compensation Association. Questionnaires were mailed during the second week of May, 1972.
The questionnaire was designed so that information could be collected on the number of firms that (1) were currently utilizing flexible compensation, (2) had investigated or attempted flexible compensation, or (3) had neither investigated nor considered flexible compensation. The questionnaire was also designed to gather additional information including data on the problems which respondents felt would be involved with implementing flexible compensation for nonexempt employees.

Seventeen firms replied that they were currently utilizing flexible compensation for nonexempt employees. However, follow-up revealed that none of these seventeen firms was actually providing true flexible compensation for its nonexempt employees as defined by the questionnaire.

Thirty-eight firms responded that they were currently investigating flexible compensation for their nonexempt employees. Eighteen of these thirty-eight firms stated that they intended to utilize flexible compensation in the future; nine stated that they did not intend to implement flexible compensation in the future. Seven of the thirty-eight who had investigated flexible compensation were undecided about future implementation, and two were still investigating the concept and had made no decision.

Only twenty-six of 346 firms answering stated that they would become involved with flexible compensation for nonexempt employees in the near future.
All questionnaire respondents were also requested to list the name and address of any person or firm which they knew as being involved with flexible compensation. These names provided additional leads for investigation into flexible compensation. All possible sources of information on flexible compensation were contacted in an effort to gather data on the subject. There was no evidence that any firm, whether within or without the American Compensation Association, was currently utilizing flexible compensation for non-exempt employees.

The problems involved with implementation of flexible compensation as listed by the questionnaire respondents were summarized as administrative costs, legal problems with the Internal Revenue Service, Fair Labor Standards Act, liability for counsel given, employee communications, and adverse selection involving various types of insurance plans.

Each major problem area was investigated to determine what solutions or alternatives were available. From this analysis guidelines for implementation of flexible compensation were developed.

Implications for further study include detailed cost analysis, longitudinal impact upon employee productivity and satisfaction, and the ability of preference tests to realistically predict actual employee demands.
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CHAPTER I

INTRODUCTION

Flexible compensation is a new concept in wage and salary administration which permits the employee to select from the various benefits and cash remuneration a plan tailored to meet his own needs, limited only by his total compensation and those statutory provisions pertaining to his wages. Under flexible compensation, the employee decides how he wishes to distribute his total compensation between cash and the benefits offered by the employer. Such a concept is not new for a very select group of high ranking corporate officials. However, for the average executive such compensation plans are perhaps unique, and for the nonexempt employee such a plan would be considered revolutionary.

Within recent years, compensation practitioners have been urged in professional journals and by after-dinner speakers to adopt flexible compensation as a way to improve their compensation programs in order to attract, hold, and motivate employees. Unfortunately, information on flexible compensation is lacking in two areas: (1) the extent to which flexible compensation has been adopted by business firms, and (2) how to initiate and install flexible compensation.
Purpose of the Research

The purpose of this research is twofold. First, the results of this study will provide empirical data on the current status of flexible compensation for nonexempt employees within the United States. Second, the researcher will contribute toward the development of a set of comprehensive guidelines for implementing flexible compensation programs. These guidelines will have the potential of assisting compensation managers who are considering initiating flexible compensation programs.

Significance of the Research

The significance of this study is that it will develop data on the current status of flexible compensation for nonexempt employees and develop comprehensive guidelines for implementation of such programs. Determining the status of flexible compensation will contribute to knowledge on the current status of compensation within the United States. Development of comprehensive guidelines have the potential of assisting practitioners in their efforts to implement the concept of flexible compensation. In addition, as far as can be determined, this is the first study to concern itself with flexible compensation for nonexempt employees.

Delimitations

The questionnaire utilized to gather data on the current status of flexible compensation for nonexempt employees was
restricted to those American Compensation Association members representing private industry within the United States. American Compensation Association members representing governmental agencies, public agencies and institutions, and Canadian members were not included in the questionnaire survey. Thus, the research, especially the questionnaire portion, does not purport to be, nor is it intended to be, a statistically representative study of the current status of flexible compensation for nonexempt employees. Even though the results appear to reflect the actual status of flexible compensation for nonexempt employees in the United States, no statistical significance should be credited to the findings.

The guidelines developed are not intended to be a detailed, step-by-step approach for implementing flexible compensation for nonexempt but rather as an overall plan to guide compensation managers in developing specific plans within their individual firms.

Definition of Terms

**Compensation** is a term used to include all forms of wages, salaries, and supplementary benefits paid to employees. An all inclusive definition of compensation has been given as "a reward for services rendered" (2, p. 1).

**Flexible compensation** for this study is defined as any compensation program which permits the employee to select from the various benefits and cash remuneration a plan...
tailored to his own need, limited only by his total compensation and those statutory provisions pertaining to his wages. Other terms such as "cafeteria," "supermarket," "smorgasbord," or "individualized" plans have also been applied to the concept of flexible compensation.

Nonexempt employees are those employees covered by the Fair Labor Standards Act of 1938 as amended and, therefore, nonexempt from the Fair Labor Standards Act's coverage. Nonexempt employees are normally paid on an hourly basis, subject to the Act's regulations on minimum wages and overtime.

Exempt employees are those employees exempt from the Fair Labor Standards Act. Exempt employees will be used to refer to those managerial, administrative, and professional employees who are not subject to the minimum wage and overtime provisions of the Fair Labor Standards Act.

Methodology

Secondary and primary data are utilized in the research. Secondary data is used to provide background information on the subject of flexible compensation. The primary sources of data include that gleaned from a questionnaire survey of American Compensation Association members representing private industry within the United States, personal interviews, telephone interviews, and correspondence.
As the first step in the research, a review of the literature was conducted which revealed that references on the subject were confined mainly to theoretical justifications of flexible compensation. Information on the status of flexible compensation for nonexempt was lacking as well as any comprehensive guidelines on implementing the concept of flexible compensation. Secondary sources, however, were vital in providing theoretical and conceptual data on this new approach to compensation.

Utilizing the background information from secondary sources, a survey questionnaire was developed. The questionnaire was field tested by having ten practitioners in the field of compensation critically evaluate the questionnaire. Based upon the recommendations of these ten practitioners, the final questionnaire was developed. A copy of the questionnaire used is in the Appendix.

No effort was made to develop a questionnaire sample which would be a random sampling of American industry. Instead, the questionnaire was restricted to members of the American Compensation Association representing private industry. It was felt that the American Compensation Association was an ideal group to sample since one of the major purposes of this organization is: "To further the exchange of information among its members with current practice and research in all phases of employee compensation, including wages, salaries, pensions,
group insurance, and other related forms of employee remuneration" (1, p. c). More than 1500 individuals are members of the American Compensation Association, representing industry, federal and state agencies, hospitals, universities and other public agencies in the United States, Mexico, and Canada. From the 1972 Membership Directory of the American Compensation Association only private industrial enterprises were selected to receive the questionnaire. As such, 668 questionnaires were mailed to 666 corporations during the second week in May, 1972. Out of the 666 corporations included in the survey, 280 are currently listed in Fortune's Directory of the 500 Largest Industrial Corporations (3, pp. 170-204).

July 1, 1972 was set as the cut-off date for receipt of completed questionnaires. By that date, 414 useable questionnaires had been returned with a response rate of 61.98 percent.

These questionnaires were then analyzed and tabulated. A follow-up was conducted whenever the data on a completed questionnaire indicated special knowledge or information on flexible compensation. The follow-up was conducted by personal visit, telephone, and by mail. Interviews were also conducted with compensation consultants, government officials, and union officials.

Based upon the results of the questionnaire and the interviews, a comprehensive set of general guidelines were developed to assist those who may attempt implementation of flexible compensation.
CHAPTER BIBLIOGRAPHY


CHAPTER II

BACKGROUND AND SIGNIFICANCE

Introduction

Compensation practices within the United States have undergone vast change during the last fifty years. Within recent years, however, critics have been claiming that compensation practices are ineffective as motivators and are, instead, sources of dissatisfaction. Often these critics suggest that flexible compensation plans are a solution to the problems inherent in today's compensation practices.

The purpose of this chapter is threefold in that the objectives are: (1) to present an overview of the historical development and status of current compensation practices in the United States, (2) to point out criticisms of these current compensation practices, and (3) to set forth arguments for flexible compensation as an alternative to present compensation practices.

The Evolution of American Compensation Structure

"Scarcely four decades ago, compensation for American workers consisted almost entirely of a wage for time worked or units produced. At that time, a worker's average straight-time hourly earnings were indicative of his total compensation" (2, p. 17). During the 1930's, compensation in addition to
straight-time pay began to take on added importance as the nation's social philosophy toward economic security changed. The National War Labor Board's attempt at controlling inflation in World War II subjected wages to strict regulations. However, the National War Labor Board approved the adoption of alternatives to pay increases in the form of vacations, holidays, sick leave, insurance, profit sharing, and pension benefits. At that time, says Douty, "a variety of fringe benefits - the term was invented in 1943 - made their appearance. This laid the basis for the remarkable growth of benefit practices during the postwar period, and the development of the 'package' - some mix of wage rate and fringe benefit increases - in collective bargaining" (10, p.3).

Added impetus was given to the growth of fringe benefits by the courts in Inland Steel v. NLRB (26, pp. 2506-2524) in 1948 and W. W. Cross and Company v. NLRB (27, pp. 2068-2071) in 1949 where it was held that pensions, retirement benefits and insurance plans were bargainable issues under the Wagner Act. Wage and Price controls during the Korean conflict, as in World War II, encouraged expansion into fringe benefits.

Paid Leisure

By 1940, only one out of four workers covered by collective bargaining agreements received paid vacations. Three years later, sixty percent of these organized workers were entitled to paid vacations mainly as a result of the National
War Labor Board's decision establishing a standard plan of one week's vacation after one year of employment and two weeks after five years (41, p. 1). Today, twenty-six percent of the nation's plant workers and seventy-nine percent of the office workers receive two weeks of vacation after only one year of service (43, p. 42). Since 1960, the percentage of plant workers eligible for three weeks of vacation rose from twenty-seven to sixty-six percent, while office workers jumped from thirty-eight to eighty-two percent. In addition, approximately one-seventh of the plant workers and office workers were eligible for five weeks of vacation pay, generally after twenty-five years of service. Such provisions were practically nonexistent in 1960 (43, p. 42).

Paid holidays, like vacations, were uncommon for most employees until after 1943. By the end of World War II, the National War Labor Board had accepted six paid holidays as standard compensation. While a significant number of non-manufacturing industries still continue to grant six paid holidays, the trend within the last five years is toward nine paid holidays (43, p. 42). Also, there has been a general trend toward longer weekends by utilizing "floating" holidays when traditional holidays fall on either Tuesday or Thursday.

Profit Sharing and Pensions

While it appears that the first profit-sharing plan was established in the United States in 1794, only sixty such plans
were found in a 1916 Bureau of Labor study (15, p. 3). Out of one hundred ninety three plans which had been installed in the United States by 1937, less than half were still in existence (15, p. 3). No significant development in profit sharing was noted until World War II.

The American Express Company initiated the first pension plan in the United States in 1875 (14, p. 3). By the mid-1920's, there were some 400 pension programs in effect, many of which covered only salaried employees (14, p. 2). Like profit sharing, there were no major developments in the area of pensions until World War II.

The popularity of pensions and profit sharing after 1940 was due to a combination of wage controls, a tight labor market, and government tax policies. While an employer was restricted in granting wage increases, the National War Labor Board did not hold pensions and deferred profit sharing as inflationary. Furthermore, after 1940, deferred plans meeting Internal Revenue requirements gave employers an attractive method of recruiting and holding employees in a tight labor market. Employers could now deduct up to fifteen percent of total compensation expense for those contributions qualifying as deferred pension and profit sharing plans. Such deferrals were also attractive to employees since they were not subject to taxation until collected at retirement with any lump-sum payments treated only as capital gains. Between 1940 and 1946,
the Internal Revenue Service approved 2,471 deferred distribution plans (15, p. 4). In addition, organized labor's interest in deferred compensation increased after World War II stimulated the growth of pensions and profit sharing. By 1969, employers were maintaining 173,452 qualified deferred compensation plans: "This figure is almost four times the figure reported just one decade earlier (1958), and that figure was over four times the 1948 total! Hence, there was an almost sixteen-fold increase in twenty years" (45, p. 1511).

Private Insurance

Life, accident, and health plans beyond statutory requirements under workmen's compensation laws also began to grow substantially during World War II as a substitute for wages. Historical data illustrating the coverage under health plans not underwritten or paid directly by federal, state, or local governments is presented in Table I.

While Table I demonstrates the rapid growth in the number of employees covered by private insurance plans since 1950, Kolodrubitz (25, p. 39) predicts a much slower growth rate in future years. However, he sees a continued high growth for new benefits within present plans to include dental, vision, prescription, and medical care (25, p. 39).

Urban plantworkers and officeworkers as a group tend to have a larger percentage under private insurance coverage than the labor force in general. In addition, the urban
employee was more likely to have his employer pay the entire cost of such a plan (43, p. 41). Table II indicates the growth of insurance plans for urban employees from 1960 to 1970.

TABLE I

INSURANCE COVERAGE AS PERCENT OF ALL WAGE AND SALARY WORKERS, 1950, 1955, 1960-68

<table>
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<tr>
<th>Year</th>
<th>Life and Death Insc.</th>
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<th>Hospitalization</th>
<th>Surgical</th>
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<th>Major Medical</th>
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<td>48.7</td>
<td>35.5</td>
<td>16.4</td>
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<td>1955</td>
<td>50.7</td>
<td>28.3</td>
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<td>54.7</td>
<td>37.0</td>
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<td>58.2</td>
<td>35.5</td>
<td>68.9</td>
<td>65.5</td>
<td>50.2</td>
<td>16.5</td>
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<td>1961</td>
<td>60.4</td>
<td>36.2</td>
<td>71.3</td>
<td>68.4</td>
<td>53.6</td>
<td>19.7</td>
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<td>60.4</td>
<td>37.4</td>
<td>71.5</td>
<td>68.5</td>
<td>54.5</td>
<td>21.2</td>
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<td>1963</td>
<td>61.5</td>
<td>40.2</td>
<td>73.5</td>
<td>70.7</td>
<td>56.7</td>
<td>23.7</td>
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<td>1964</td>
<td>63.4</td>
<td>42.1</td>
<td>73.8</td>
<td>71.2</td>
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TABLE II


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<th>Type of Plan</th>
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Cost of Employee Benefits

The evolution of compensation away from the straight-time hourly wages toward a "package" composed of wages and fringe benefits has caused benefits to represent an ever increasing percentage of total compensation. It is possible to trace the growth of employee benefits for an identical group by viewing the change in 146 firms who have submitted data in each of the U.S. Chamber of Commerce biennial surveys since 1949. This data is shown in Table III. For these 146 companies, fringe benefits have increased from 17.9 percent of total payroll in 1949 to 31.7 percent in 1969. In cents per payroll hour, fringes cost only 27¢ per hour in 1949 as opposed to 120.1¢ per hour in 1969. During this same time, the costs per year grew from $547 to $2,498 for an increase of some 357 percent in twenty years.

The figures were somewhat different for all 1,115 reporting companies in the 1969 Chamber of Commerce survey. The average payment in 1969 represented 27.9 percent of total compensation and 98.3 cents per hour, or $2,052 per year for each employee (13, p. 5).

This trend in compensation toward more benefits does not appear to be abating and will be expanded and extended into new areas (34). Current wage and price controls aimed at controlling will possibly give an additional impetus to fringe benefit programs on the assumption that benefits are less inflationary than direct pay.
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Source: Table II, Comparison of Summer 1969 and 1970 Employees for 146 Companies

TABLE II

Comparison of 1949-69 Employee Benefits for 146 Companies
Compensation and Individual Preferences

Needless to say, as fringe benefits grow in relation to cash, the employee finds that his concept of pay (basic wages multiplied by hours worked) becomes an increasingly smaller percentage of the total compensation. And, as Stasser cautions (54, p. 957), there is a "high difference" between total compensation and its relationship to an individual worker since some workers are not covered, and some of those covered will never receive any benefit from the plans.

Two compensation packages, worth the same amount of money, may have quite different values to individual employees, depending upon the composition of the benefit packages (31, p. 509). Nor are benefits valued by employees on purely economic grounds (37, p. 22). As Jones and Jeffrey have demonstrated, workers in the same industry but in different geographical sections will differ in preference and attitude toward various types of compensation plans, with unions influencing attitudinal differences. Green (18) also found that unions influenced employee perception of compensation variables. Unionized plants in the Portland area were more favorable toward expansion of fringe benefits than were non-union counterparts. Preferences for various compensation can be influenced greatly by nonmechanistic factors say Lawler and Hackman (30). The way a plan is developed and introduced, especially as to the extent of employee participation, can be critical in determining the success of compensation plans.
To gain insight into how employees might redistribute money expended by a company on compensation, Schuster (48) conducted a study whereby employees were asked to redistribute monies in a manner more closely approximating their needs. Unless the change resulted in a redistribution of at least ten percent or more, it was not considered a reportable change. The result of Schuster's research revealed that seventy-eight percent would make a change in the distribution; twenty-two percent would make no changes. "With seventy-eight percent of respondents making some change in distribution, we have indications that, given an opportunity to change a compensation package which employees feel is satisfactory, many will take advantage of the opportunity to make some change" (48, p. 9).

The following general preference trends have been identified by Schuster's research (50, p. 36).

Younger employees want more base pay at the expense of retirement while older employees want more retirement benefits at the expense of their base pay.

Professional employees prefer stock purchase plans at the expense of retirement plans.

Nonexempt employees want medical plans at the expense of retirement plans.

Women prefer medical benefits at the expense of base pay.
Men want higher base pay at the expense of retirement benefits.

Single employees prefer stock purchase plans at the expense of retirement plans.

Married people prefer medical plans at the expense of holidays.

Higher paid employees want stock plans at the expense of base pay.

Lower paid employees want more base pay at the expense of most everything else.

Employees with children prefer more medical insurance at the expense of stock purchase plans.

While these trends are useful says Schuster, each company should gather their employees' preferences since "no personal characteristics such as age, pay level, etc. correlated highly enough with the results to predict how a specific group might express preferences to various alternatives" (50, p. 36).

Lester (32) observes that external economic factors may exert influence on worker preferences between wages and benefits. As such, Lester holds that it would be desirable to have some estimate on the influence of tax and price advantages on worker preferences. As an example of external economic factors, he notes how income taxes and probabilities that store prices and rents would increase in steel towns following a wage increase caused steel workers in 1959 and 1962 to prefer fringe benefits over cash.
In a study of compensation preferences of the Northern California Local of the International Brotherhood of Electrical Workers, Nealy (36) found the following relationships:

**Age:** Age appeared to be an active determinate of preferences. Pension preferences rose sharply with age but the effect did not occur until about age 40. Other preferences, particularly the vacation plan, tended to decrease with age. The preference for hospital insurance reached the highest point in the 30-39 age group, indicating that this age group felt the greatest need for family protection.

**Job Type:** Clerical, as opposed to physical, was a determinant of preference for vacations as the clerical job-type wanted vacations more than did the "physical" worker.

**Marital Status:** Marital status was "dramatically" related to preferences for hospital insurance, indicating the importance of family responsibilities in determining preferences.

**Pay Raise:** The preference for pay raises was not outstandingly high in relation to other options. In fact, it was remarkably constant. The preference for higher wages did not change appreciably with regard to age, job title, marital status, company seniority, rural or urban place of residence, income, or number of dependent children.

After reviewing this research, Nealy concluded that: "It should be clear that the determinants of preferences for pay and benefits are extremely complex" (36, p. 11).
In a later study involving United Auto Workers, Nealy and Goodale (38, p. 357) concluded that:

The results as a whole reinforce the conclusion suggested by earlier research, that no one wage and benefit package will be highly acceptable to more than a subset of employees. This suggests the following two changes in industrial practice: (a) Smaller rather than larger bargaining units offer the kind of flexibility in compensation negotiations that could be responsive to local preferences. (b) Some degree of individual choice in wage and benefit selection might be beneficial. Various voluntary enrollment insurance and medical care programs offer this feature at present, but they usually involve employee contributions.

Haire, Ghiselli, and Porter (20) note that both management and labor often argue that they provide compensation in line with "what labor wants." However, they point out that:

These data suggest that it is impossible to say what labor wants, unless a careful study is made of the demographic characteristic of the group, its attitudes, the neighborhood, and the plant history. In fact, neither side knows what labor wants. This is particularly unfortunate since the techniques for finding out are easily available. The argument over the other person's desires could easily be based on fact instead of fancy. A somewhat similar situation exists with regard to the perception of salaries. Most companies have implicit or explicit weighting of factors which determine pay and raises -- successful performance, seniority, job knowledge, labor market, and the like. The list is a long one. Most employees have some weighting of these factors in their perceptions of pay and of what they are paid for. It is at least a horrible possibility that those weighting do not agree. If they do not, then what happens to incentive (20, p. 6)?

Management often views its role as a reactive one which responds to what the union negotiators present as employee preferences. This tends to place responsibility upon the union
to know what employee preferences are. "It seems clear, however, that most unions do not systematically measure rank-and-file preferences for alternative forms of compensation" (38, p. 357). The ability of a union negotiator to predict the preferences of union members appears to depend upon both the members and their negotiators having similar backgrounds (31). Thus, first level union officers may be capable of predicting member preferences with high accuracy; however, the ability to negotiate preferred alternatives may diminish when higher-level union officers conduct negotiations. "This might be an especially acute problem where large national unions are involved and bargaining is done on a nationwide basis" (31, p. 516).

Criticism of Present Compensation Practices

If individual preferences are not determined by firms before establishing their elaborate compensation systems, how then are such decisions made? Unfortunately, according to Schuster, "Decisions as to the makeup of a firm's compensation package are typically based on information on compensation practices in other firms. Consequently, most compensation packages are very much alike, and may not be responsive to the needs of a particular firm's employees" (48, p. 1). Or as Lawler notes, "most organizations seem intent on keeping their compensation programs up with, but never ahead of, the Joneses in a sort of 'me too' behavior"
(29, p. 21). As a consequence, Schuster and Lawler are of the opinion that many organizations are not obtaining maximum results from the monies expended on compensation.

Cassell blames the impersonal approach to compensation on the dual personalities interacting within compensation managers:

The old entrepreneur in him wants the system to be responsive to individual achievement, but the new bureaucrat in him wants it administered according to yardsticks or guidelines that can be defended as "fair." He wants it predictable and certain. He sometimes goes so far as to write "carry-over" provisions into incentive plans in order to provide a stable pool of money that will be available from year to year and thus insure that magic stability.

Under these circumstances, the incentive compensation system ultimately exhibits a pattern of aging. In the beginning, a strong effort is made to consider each person individually on a man-to-man basis, to measure his contribution to the organization and to decide upon the amount of compensation he should receive. But as time goes by, the administrator becomes acutely aware of the difficulties in measuring and justifying such differences. He becomes increasingly aware of the interdependence of departments and of functions, and of the fact that one man's outstanding contribution may become visible only in another man's accomplishment (7, p. 13).

This uncertainty and aging is not limited to executive compensation, as Cassell notes a parallel in hourly worker's wage incentive plans which have evolved from individual plans into group plans as production became more a matter of group effort. Not only have individual plans evolved into group plans, but also into department, divisions and even major product segment plans. Thus, for both the executive and hourly employee, there has been a transformation in incentive plans away from individual participation to group efforts.
However, as Porter and Lawler note, the rewards for the manager are more nearly proportionate to the quality and quantity of his performance than that of the nonmanagerial worker (44, p. 121). At least, for the manager, there is flexibility to give rewards based upon performance. And, in addition, managers tend to have greater opportunity for gaining intrinsic rewards from their jobs based upon their efforts and performance. For the nonmanagerial worker, rewards are generally determined completely by fixed schedules which provide the same amount of pay for all employees holding that type of job. Unless the hourly worker's performance is totally unacceptable, his pay will not be lowered; conversely, it likely will not be raised easily by above-average performance. The nonmanagerial worker's opportunity to gain intrinsic rewards from job performance are frequently limited by work flows and union contracts. "In short, the bulk of his rewards are determined not by how good or poor his job performance is but by factors that are largely or totally beyond his personal control" (44, p. 121).

Schuster and Brady contend that a major problem of compensation arises out of inflexibility which can pervade the entire organization and cause a loss of effectiveness unless compensation people are constantly looking for new ways to make pay decisions. It is their contention that the "process used to access and respond to compensation needs
last year will probably be much less responsive to current issues and certainly inadequate for future use" (51, p. 201).

Schuster and Clark note:

For years, salary administrators have stated that one objective of their salary administration program is "fair salary treatment." They knew this had something to do with the orderly administration of pay and something they called a "fair day's pay for a fair day's work" but they did not determine whether "givers" and "receivers" felt the same way about pay (52, p. 591).

It was this inflexibility and inability to meet current issues which Rosow had in mind when he published his recent memorandum on "The Problem of the Blue-Collar Worker" (47). Rosow points out that some forty percent of American families, which includes seventy million family members, have incomes between $5,000 and $10,000 a year and might be termed "lower-middle income." The head of such a household is usually a fully employed blue collar worker, but many are also in white-collar or service jobs. The heads of these households most often have heavy family responsibilities, and it is when their children reach their teens and family budget costs are at their peak when two things happen to the majority of such breadwinners:

They reach a plateau in their capacity to earn by promotion or advancement; their expenses continue to rise, as the last family members are born, as they become homeowners, as car and home equipment pressures mount, as the children may become ready for college, or support is needed for aging parents. The American wage and salary structure does not respond directly to this situation, since it is based
on the ethic of "equal pay for equal work." It does not provide additions for either growing family size or age (except as it may reflect job seniority); payment is exclusively for work done--the same pay is given to everyone in the same job; and, unlike the situation in many other countries, the wage structure is not supplemented by public payments based on family size, although income tax exemptions give some recognition (47, p. 2).

However, as Haire, Ghiselli, and Gordon illustrate, the executive's pay curve does not fit his demands very well either. "That is, pay is low when Junior's teeth are being fixed, sister is going to college, and the mortgage payments are due. After these crises have passed, pay increases" (19, p. 9).

Discussing the aspect of "equal pay," Belcher comments: "Contrary to the traditional assumptions of compensation administration, providing for equity does not automatically produce motivation. Perceived equity leads to satisfaction, but satisfaction and performance are quite different things" (4, p. 92).

It is for this very same reason that Porter and Lawler attribute the lack of strong, positive, relationships found in research between satisfaction and performance, since it is nearly impossible for most workers to receive varying amounts of rewards, and thus satisfaction, as related to performance (44, p. 121).

Taylor notes a dichotomy in the function of compensation, depending upon where one stands (56). To the employer, compensation is an expensive device utilized to (1) recruit
and maintain competent employees, (2) denote the pecking order
of jobs, and (3) motivate employees by judiciously mixing
rewards with punishments. Compensation is neither bad nor
good in itself, but rather an instrument to be evaluated in
terms of results as measured against costs incurred. For
the employee, however, compensation performs the functions of:
(1) providing income for present and future needs, (2) an
evaluation of results in comparison with his peers, and (3)
prestige in terms of his self-esteem. Therefore, Taylor points
out:

By juxtaposing these two functions of compensation,
we get a hint of where problems could easily arise.
The employer's concept of compensation is objective and
active—it is something by means of which he manipulates
other people for his own purposes. The employee's
concept, however, is subjective and passive—it is
something to which he is subjected for the purposes of
other people. No matter that the amount is "satisfactory,"
the traditional compensation manager's approach to the
matter derogates from the human dignity of the individual
employee who feels that he is equated with a job
description and a point on a least-squares line . . .
(56, p. 492).

And furthermore, continues Taylor:

To the employer, the total compensation package
is normally a standardization commodity, but a little
differentiation may be allowable on an exceptional
basis for the favored few at the top of the executive
pyramid. The larger the corporation, the greater the
pressure toward standardization and toward bureaucratic
administration. The commodity is considered a "good"
commodity and its competitive price is "right" because
they have been checked out objectively by area and
industry surveys. All that remains is to sell the
package to a relatively captive body of consumers
(56, p. 493).
The problem then, according to Taylor, is indeed difficult due to the "profoundly different" frames of reference. "No matter how enlightened the compensation program may seem to its designers and sponsors, his having to spend a substantial part of his total compensation (the benefits part, which may be 25 percent or more of the total) in purchasing a set menu at the company store inevitably rankles him. After all, he was brought up in a society whose ethos stresses the sacredness of the human individual, his right to dignity, and his command over his own destiny" (55, p. 23).

Taylor adds that employee benefits, with which personnel managers hope to gain gratitude, loyalty, enthusiasm, and positive attitudes, frequently become a source of irritation and discontent. After developing hypothetical benefit plans for a $5,000 and a $10,000 a year employee, Taylor states:

But now we can begin to see why employees do not react as expected to lavish benefits packages. In the two examples above we are saying, in effect, to the first man: "Your value to us is $6,689 a year, but we are going to pay you only $5,000 in cash and give you a carefully devised benefits package which we have decided is best for you and which is equivalent to an additional pre-tax income of $1,689." To the other man, we say the same thing, in effect, except that the figures are $14,329.57--$10,000 in cash and $4,329.57 in kind. "You are competent enough to work for us, but you are not competent enough to organize your private life to be trusted with your full earning." So, for the lower paid man, we spend 25 percent of his total earnings on his behalf, leaving 75 percent to be spent according to his own wishes; for the higher-paid man, we decide that although he is more valuable to the company, he is even less competent in organizing his private life, so we spend 30 percent of his total compensation on his behalf,
leaving him with only 70 percent to be spent at his own discretion. And we have moved away from paternalism? The truck system of wage payment is illegal?

Let us spell out again the "message" we put across by our deeds rather than by our words, and we know which of these alternatives speaks the more loudly. We are saying, "You, John Doe, are incompetent, in our opinion, to be trusted with spending 25 percent of the total earnings to which you are entitled because of your competent performance in discharging your responsibilities to the corporation; and you, Richard Doe, cannot be trusted to spend 30 percent of your total earnings. Therefore, we, with our superior knowledge and greater wisdom will spend these amounts on your behalf (56, p. 498).

The Current Status of Compensation

Dunnette's list of generalizations on compensation provides a critical overview on the current state of the art:

1. Level of pay should be based mostly on longevity, "staying-power," seniority, or whatever you may wish to call it. The notion seems to be that the long-running, older human machine is always worth more than the brand new one.

2. It doesn't matter how people are paid; whatever fits the accounting system most efficiently is the best. Hence, a monthly pay check or merely implanting a blip on a computer tape is just as "good" as handing out silver dollars or bags of gold.

3. The worst sin of salary administration is to overpay a person because overpayment implies a "bad deal" for the company in the purchase agreement.

4. As long as no one is complaining about pay, everything is OK.

5. People will take as much as they can get and will always be looking for more.
6. Pay policies and practices should be engineered to be the same for everyone; individual differences among different human elements may be taken into account in determining the cost of each element, but the strategies of salary determination and the techniques of payment needn't differ from person to person (12, p. 11).

According to Dunnette, these assumptions probably arose from an overattention to the cost side of the cost-behavioral equation. Since dollars were involved, a "commodity purchasing and cost account philosophy" took hold of the compensation manager's thinking even though lip-service was paid to the so-called "human element."

As for the large outlays for fringe benefits, it can be questioned whether they even serve as incentives since they are often considered a right of employment rather than a reward for performance. "In other words, everyone at the same salary level is treated alike. To be sure, the right to these benefits normally increases with responsibility, which presumably reflects the individual's performance" (42, p. 144). Organized labor's view that fringe benefits are mere proxies for wages and a right of employment is demonstrated by Arthur Goldberg's testimony on behalf of the Steelworkers before the New York State Department of Insurance:

The union and the management come to the bargaining table with some appraisal as to how much money there is in the "kitty" for an increase . . . it is the total cost of improvements which provide the framework within which the unions and the management bargain. . . . The choice of one approach--level of benefits or cents per hour, or perhaps percentage of payroll--does not at all diminish the importance to the beneficiaries or to the union of how the money is being spent (54, p. 957).
Herzberg's (21) hypothesis that pay and benefits are only maintenance of "hygiene" factors that do not motivate can be considered an indictment of current practices. For if Herzberg is correct, current compensation practices, regardless of costs, can at best only prevent employees from becoming dissatisfied.

The total compensation package loses much of its potential as a motivator when employees do not know the extent of benefits being provided (4, p. 253; 56). "The average employee knows his net or gross pay to the penny, but not many can tick off what they would receive if they were disabled by a heart attack, say, or how much they have socked away in the company's profit sharing plan" (40, p. 94).

Dempsey (9) criticizes management for using rich and varied benefits to entrap employees and discourage thoughts of moving on. Such "entrapment theories" do not work according to Dempsey since it has the opposite effect intended in that it discourages movement of only marginal or limited employees who are strongly motivated by security and status quo. "In short, the only people this approach will affect are those seeking in a company a home, not a challenge. Thus, the organization is in the process of being strangled by the very theory that was intended to guarantee it long life" (9, p. 45).

Dunn and Rachel conclude that: "present compensation programs have failed to attract, hold, and motivate employees
because traditional programs do not consider the individual" (11, p. 395).

Taylor presents a pessimistic view of the situation:

Conventional wage and salary benefits administration has reached the end of the road. It is a major source of dissatisfaction, disincentive, and friction between employer and employee. Even with the most competent administrators, this is true because conventional programs in these areas are vitiated by an inherent conceptual flaw; they accentuate the conflict between the individual employee's frame of reference. This conflict is not superficial but is deeply rooted in the clash of two contradictory value systems--one individualistic, the other authoritarian (56, p. 508).

Flexible Compensation - An Alternate Solution?

The solution to the problems of compensation says Taylor, is to apply the same principles of freedom of choice to compensation that is basic to the free economic market. "We must think in terms of total compensation for each job, but with this total divisible at the employee's discretion into a mix of compensation and benefits tailored to his needs and desires (55, pp. 23-24).

This would require an expansion of the compensations manager's role so that he becomes an active merchandiser of a variable array of attractive benefits. As a result, this concept has been termed by Taylor the supermarket approach analogous to the supermarket manager who keeps his shelves well stocked with attractive wares. Others have termed this
concept as "cafeteria," "smorgasbord," or "buffet" plans. Practitioners generally group these various terms under the heading of flexible compensation.

Lawler, noting that studies have shown that different compensation preferences exist, concludes:

These studies suggest that, at the very least, organizations may need different benefit packages in different locations, depending upon the personal characteristics of the workers in each installation. A further step that organizations could take would be to design different packages for groups of individuals who have similar characteristics. Indeed, it may be that the optimum solution to this problem of different compensation preferences is for organizations to adopt a "cafeteria" compensation program. A "cafeteria" compensation plan would allow every employee to divide his compensation dollars among the benefits offered by his company. This would allow each employee to select the compensation options that he values most without adding to the compensation costs of the company (29, p. 21).

Baytos (3, p. 26) provides a very simple example of how a "smorgasbord" or flexible compensation program might operate.

<table>
<thead>
<tr>
<th>Value of benefit offered</th>
<th>Portion that may be taken in cash</th>
<th>Approval Required</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Paid Vacation (2-4 weeks)</td>
<td>1/2</td>
<td>Superior</td>
</tr>
<tr>
<td>2. Paid Holidays (9 days)</td>
<td>None</td>
<td>------</td>
</tr>
<tr>
<td>3. Stock Purchase (3% of salary)</td>
<td>All</td>
<td>None</td>
</tr>
<tr>
<td>4. Deferred Profit Sharing (10% of salary)</td>
<td>1/2</td>
<td>None</td>
</tr>
<tr>
<td>5. Insurance (not included)</td>
<td>None</td>
<td>------</td>
</tr>
</tbody>
</table>
Using the basic elements in Table IV, annual values derived for three salary levels are estimated by Baytos as indicated in Table V.

**TABLE V**

**MAXIMUM CASH VALUE OF SAMPLE PROGRAM**

<table>
<thead>
<tr>
<th>Benefit</th>
<th>Age 25 $10,000</th>
<th>Age 40 $20,000</th>
<th>Age 55 $30,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Vacation</td>
<td>$190</td>
<td>$575</td>
<td>$1,155</td>
</tr>
<tr>
<td>2. Stock Purchase</td>
<td>300</td>
<td>600</td>
<td>900</td>
</tr>
<tr>
<td>3. Deferred Profit</td>
<td>500</td>
<td>1,000</td>
<td>1,500</td>
</tr>
<tr>
<td>Smorgasbord Choices</td>
<td>$990</td>
<td>$2,175</td>
<td>$3,555</td>
</tr>
<tr>
<td>% of Salary</td>
<td>10%</td>
<td>11%</td>
<td>12%</td>
</tr>
</tbody>
</table>

Baytos points out that the sample given is a very simple program. Yet, the dollar amounts can be substantial even under a simple program. In this instance, the maximum value of the choices was $990 for the employee at age 25 earning $10,000, whereas for the 55 year old employee earning $30,000 the value of the choices was $3,555. As a percentage of pay, there is little variation among the three salary levels. However, had insurance and pensions been included, there would have been considerable variation in the percentages of salary represented by the choices since such benefits are determined on the basis
of age. Addition of pensions and insurance would sharply increase the income potential of a smorgasbord or flexible plan.

If the principle of flexible compensation were to be fully applied, it would necessitate construction of a separate program for each employee—clearly an impossible undertaking according to Taylor:

Apart from the enormous labor involved, there are also legal constraints that mandate certain benefits, and insurance and retirement plan requirements set limits to an employee's freedom to move in or move out of a plan, once committed. Fortunately, theoretical perfection does not seem to be necessary to successfully implement the supermarket plan. We do not really need an infinite variety of items. What we need are a limited number of basic choices that will take care of the differing circumstances, needs, and desires of various broad categories of employees. This will not merely make the program manageable, it may even be desirable from the employee's point of view. He can be expected to have views on the relative merits of an increase in his "cash flow" or in deferred benefits, on greater health or accident insurance as against a company car, a company-subsidized housing loan, or an educational loan or grant. But really it is putting too great a burden on the individual to ask him to spell out in precise detail all the items he would like from an infinitely long list. There is an economy and efficiency in economizing on choice that is a benefit in itself. We cannot as a practical matter expect the employee to be all-wise and all-knowing, any more than we can expect it of the compensation manager. We must make reasonable allowance for human limitations (55, p. 26).

Flexible Compensation Is Not New

Flexible compensation is not an entirely new concept in compensation. Key executives are often given considerable
freedom in determining how their compensation will be distributed between cash and other benefits. Within recent years, a growing number of large companies have provided top executives with the personal services of an expert financial consultant to assist them in designing their compensation and in investing their income (39, p. 26). Newly hired employees, especially executives, may sometimes be permitted to devise their initial compensation programs. But, as Schuster, et al indicate, "These offerings do not usually change during the term of the employee's service. The most obvious problem is that the original choice is not responsive to the changing need or preferences of employees or the firm" (53, p. 28).

Options In Traditional Plans

Options within wage plans are also not new. It is a general practice in benefit administration to offer options on a plan-by-plan basis. For example, within a pension plan, the employee may be given the option of contributing and has options on how he desires to receive his income upon retirement; lump sum, guaranteed life, surviving income, and so forth. Medical plans may permit inclusion of dependents or additional coverage such as major medical, generally on a contributory or employee-paid basis. Savings plans may permit the employee to elect from various forms of investments (stocks, savings, government bonds, etc.) up to a set maximum percentage of wages. Options on a plan-by-plan basis are not considered
true flexible compensation because the employees are not permitted to select from the various benefits and cash remuneration a plan tailored to meet the needs of the individual by dividing the total compensation between preferred plans. Plan-by-plan options merely let the employee have some limited choices within plans established by the company. "The problem here is that in many cases the employee is selecting between alternatives he did not really want anyway" (53, p. 28). In flexible compensation, employers offer options and alternatives consistent with known and expressed preferences of his employees.

The Development of Interest In Flexible Compensation

The concept of individualized, flexible compensation as a philosophy of compensation on a broad scale is relatively new. The initial research into pay preferences which contributed heavily to the current interest in flexible compensation began basically in 1963 (1, 53). A review of literature reveals an increasing interest in flexible compensation during the last few years. Baytos (3, p. 16) claims that the increasing interest in flexible compensation stems from an uneasy feeling about the effectiveness of current benefit programs. This uneasiness arises from at least two important factors--costs and relevancy. Not infrequently, says Baytos, managers are doubting whether such expensive benefit plans either achieve company objectives or meet employee needs as well as they should.
The uneasiness over relevancy is due to the great influx of the 20-30 age group into the workforce:

The young are likely to view across-the-board benefit programs as paternalistic and not responsive to their individual needs because of the educational and sociological environment in which they have formed their basic view of life in business. As a group, they are also likely to be more interested in immediate cash rewards and relatively unconcerned about the security represented by the far-distant payout of pension plans and the limited probability of their incurring the hazards covered by typical insurance programs (3, pp. 16-17).

Lawler sees this concern over the younger generation and the "new-life-style" worker as well grounded. While admitting that all generations are different, Lawler sees this younger generation as more different: "That is, its values, attitudes, and norms depart more radically from those of the immediately preceding generation than did those of earlier generations from their immediate predecessors" (28, p. 19). These differences in values and attitudes, which Lawler says stand out are: (1) a demand for immediate gratification and rejection of the view that some things must wait, (2) a rejection of the concept that authority comes with position and age, (3) a desire to participate in decision making, (4) a rejection of traditional ways as being the correct way, (5) a desire for openness and distrust of decisions and actions taken in secret or behind closed doors, and (6) a concern for their own intellectual and emotional growth which causes the new generation to be much more mobile in changing jobs and geographical
locations. As such Lawler doubts whether most compensation programs at present can respond to those new attitudes and values thereby causing flexible plans to take on added importance.

The ability of compensation programs to respond to the new generation is indeed a source of concern since by 1980 some one-half of the work force in the United States will be accounted for by young adults in the 25 to 34 age bracket (22). Within the next ten years, there will be more than a forty percent increase in the 20 to 34 age group labor force compared with only some 5.5 percent in the 35-44 age group (65). In addition, many of the younger employees will have had exposure to college which makes them potentially "a comparatively less satisfied group than its non-college educated counterparts performing roughly similar jobs (24, pp. 207-208).

Flexible compensation would make compensation decision participative and open, thereby satisfying the values and needs of the younger generation. Permitting more voice in management decisions in general as well as compensation may be a natural evolution of organization philosophy (5, 33; 8). It might be expected that those firms leaning toward a participative approach to management will find flexible compensation to their liking.
Motivation - The Major Objective of Flexible Compensation

Proponents of flexible compensation claim that compensation must become individualized in providing rewards if compensation is to attract, hold, and motivate employees. With flexible compensation, rewards are individualized and can thereby motivate all employees, whether they are new-life style employees or members of the "older" generation. Motivated employees would presumably be more productive and thereby contribute to a higher standard of living through better utilization of resources, including pay and fringe benefits.

"Compensation is a reward for services rendered" (11, p.1). These rewards are merely attempts by management to shape and control behavior of employees so as to accomplish organizational goals. Thus, organizations are concerned with psychological learning or behavior. Psychology provides support for individualized compensation.

Whaley and Malott note: "In the study of psychology, years of observation and experimentation have led us to believe the determining factor in the behavior of an individual is what follows the behavior. If the behavior yields a reward for an individual, the behavior will be retained and increase in frequency" (58, p. 241). The problem is, however, that the "object, prestige or dispensation offered by the giver as a 'reward' may not be viewed in the same manner by the recipient" (58, p. 2.1). Thus, the "reward" does not
always turn out to be a positive reinforcer as compensation managers often discover. "Only those events or objects that follow a behavior and subsequently increase the frequency of that behavior are defined as positive reinforcers" (87, p. 2.12).

The problem for managers who are attempting to insure that learning occurs within the organization would seem to be that of merely finding the proper positive reinforcer to reward the desired behavior. However, it has been shown in experimental psychology that the proper stimulus situations and the proper reward can be present, yet the organism fails to execute the desired behavior. The organism may have learned how to respond but such learning is latent and concealed until some new or increased incentive brings forth the latent or unused behavior. Organizations often find that their employees, both exempt and nonexempt, appear to be capable of being productive yet fail to ever display their potential talents.

Cognitive theorists would not agree entirely with the above role of rewards in determining behavior. According to cognitive theory, employees can learn by merely experiencing a stimulus situation and that the purpose of reinforcement is to permit learning to be manifested in performance (17, p. 72). This view permits latent learning to occur so that employees may know the proper behavioral response but do not utilize it until some new incentive brings forth the latent learning.
Hull's (23, pp. 140-146) explanation of latent learning lends itself to compensation programs designed to shape behavior through its "reward" practices. In Figure I, the upper curve represents the learning or reaction potential ($S^E_R$) when the incentive reinforcement ($K$) is large whereas the lower curve represents learning when the reward is smaller. Connecting line A reveals how an increase in incentive reinforcement at trial 10 will cause animals trained with small amounts of $K$ to rapidly become equal in reaction potential with those trained all along with higher incentive reinforcement. Likewise, a reduction in incentive reinforcement from the upper curve equal to that of the lower curve on the fifteenth day causes the reaction potential to drop almost immediately (line B) to that of those trained all along on the smaller reinforcements. "Thus, the larger the value of $N$ at the time of the shift in $K$, apparently the greater will be the resulting change in reaction potential" (23, p. 144).

An employee's behavior ($S^E_R$) may be latent or below some set standard until the proper amount of compensation or reward is applied. It is also plausible to interpret the lower learning curve as reaction potential arising from an undesired or neutral "reward" which does not serve as a positive reinforcer to the individual concerned; the upper curve could then represent a different reinforcement which is valued.
Reinforcer effectiveness, of course, is contingent upon both antecedent conditions (deprivation, nature of response, concurrent activity, and quantity/quality of reinforcement) and consequent conditions (response rate, resistance to extinction, intermediacy of schedule of reinforcement and tolerance for punishment) (58, p. 17.27). However, once an item is found to be a positive reinforcer, it can be generalized that: "Increases in the amount of reinforcement produce an increase in the reinforcement effectiveness" (58, p. 17.16). Therefore, knowing individual preferences for reinforcers and permitting the individual to choose his own incentive motivation (K) through flexible compensation could permit compensation managers to manipulate learning curves. Furthermore, flexible compensation would permit the individual employee to select the amount of K (reward)
necessary to produce the behavior desired by the organization.

Vroom's individualized motivational model defines motivation as a "process governing choices, made by persons or lower organisms, among alternative forms of voluntary activity" which is also relevant to compensation (57, p. 6). Two critical aspects of Vroom's model are the concepts of valence and expectancy. Individuals have various preferences or valences among possible outcomes. "The valence of an outcome is a monotonically increasing function of the algebraic sum of the products of the valences of all other outcomes and his conception of its instrumentality for the attainment of these other outcomes (57, p. 17). Expectancy is the association between the action and the outcome (57, p. 18). In other words, expectancy is the belief that a particular action will be followed by a desired outcome. Thus, Vroom hypothesizes that: "The force on a person to perform an act is a monotonically increasing function of the algebraic sum of the valences of all outcomes and the strength of his expectancies that the act will be followed by the attainment of these outcomes (57, p. 18).

Vroom's model of motivation can be expressed in the following manner:

Valence x Expectancy = Motivation → Actions → Goals
As an example, assume that an employee prefers higher income (valence) and believes that higher productivity will lead to higher income (expectancy). The preference for higher income and the expectancy that productivity will lead to higher income motivates the employee to increase productivity (action).

Utilizing Vroom's model, compensation managers should take into consideration individual valences and expectancies when designing compensation programs so that employees perceive their productivity as leading to desired goals. However, when compensation and promotions are dependent upon external factors such as union contracts, seniority, or management-administered programs, then one would expect that the instrumentability of productivity leading to goals to be low. Galbraith and Cumming's (16) study using Vroom's model confirms this expectation by demonstrating that productivity is related to motivation where the acquisition of the desired outcome is dependent upon one's own actions and not when such preferred outcomes are dependent upon non-related factors such as collective bargaining or seniority. Myers's study can also be interpreted using Vroom's model since his dissatisfied workers were dissatisfied not only with pay but with the unfairness and lack of recognition it represented (35).

Flexible compensation would permit pay to become a motivator within Vroom's conceptual framework since the organization could provide instrumentality between actions
and outcomes. However, Schuster cautions against oversimplification of making pay a motivator once again:

Managers can make pay become a motivator for individuals who perform for pay—if it is directly related to performance and people know that a caused relationship exists.

Managers must discriminate between those giving the desired performance and those not, by making the difference in the size of reward consistent with the magnitude of difference in performance (49, p. 36).

Otherwise, continues Schuster, if individuals with poor performance are retained and obtain raises, good performers will distrust the pay-performance relationship. Attempts to make the low performers "feel good" threatens the motivation potential of compensation programs.

Theoretical Problems

Flexible compensation, in theory has the potential of motivating employees and permitting organizations to get the maximum benefit out of their compensation expenditures. However, there appears to be problems in implementing the concept. Taylor (55) warns that flexible compensation is much more complicated than existing plans and would require a more sophisticated staff to administer. And, according to Taylor:

The actual plan mechanics, the accounting and acturial aspects, could get extremely complicated. There is, for example, the complication of pricing out each item on a comparable basis when salary is paid in pretax dollars and each individual has his own tax rate. The "price" of each benefit item will vary from individual to individual according to his tax bracket, yet we want to deal equitably...
with all individuals so their compensation in pretax dollars is the same for the same job classification after we allow for merit evaluation and the individual's place in the rate range. These problems, perhaps insuperable ten years ago, are technically manageable today because of computer programs (55, p. 29).

Pensions and group insurance also pose as potential problems for flexible compensation. Employers can provide coverage at a much lower cost than the employee because:

The company buys its benefits with before-tax dollars, whereas the employee has to pay taxes on his income before he can buy the benefits. Thus more employee dollars would be required to provide the same level of benefits.

The tax-free investment return of "qualified" trust funds is a feature that the employee cannot readily duplicate on his own.

Through highly standardized plans, which treat everyone essentially the same, the company can provide benefits with lower administrative costs than if the benefits were offered in a complex series of choices (3, p. 19).

Brdlik (6, p. 58) points out that the actuarial tables are stacked against the younger employees. Therefore, Brdlik states: "We want to be able to tell him what it actually costs us, what it would cost him on the open market using his own after-tax dollars and what it will be worth when he is, say sixty years old" (6, p. 58).

Flexible compensation could possibly increase the costs of pension and profit sharing plans which at present are administered on a group basis with any forfeiture staying in the trust to provide larger benefits for those who stay in the
fund. Placing participation on an all-or-none basis would cause pension costs to possibly increase by as much as 100% for the younger employee in his mid-twenties (3, p. 21). Minimum participation or base plans would help offset possible increases in costs.

Insurance plans could also become more expensive due to adverse selection when choices are made available on various coverages. For example, it is possible that only those needing dental work or those needing maternity coverage would select such coverage, thereby forcing premiums higher based upon the insurance company's experience. Many insurance companies have underwritten standards which pose as problems for flexible compensation (3, p. 21).

Legal problems also present potential problems since compensation is covered by a complex structure of federal and state laws and regulations. Flexible compensation would possibly raise some awkward tax problems for employees and employers alike. "Clearly, if a company did adopt the plan, its tax and legal experts would first have to scrutinize it most thoroughly, and once in use, it would require continuous liason between the personnel department and the tax and legal departments" (55, p. 30).

Double pay under flexible compensation for vacations and holidays might be costly since the firm could lose regenerative benefits of vacations and holidays. And too, vacation and holiday work may be marginally productive.
Baytos foresees flexible compensation as requiring better and clearer information than is now generally available for company sponsored benefits (3, p. 23). Specialists would have to be available to help employees in deciding difficult choices. More time would be required to administer information needs and communications concerning benefits. However, like Taylor, Baytos believes that the computer makes flexible compensation programs a realizable goal and worthy of consideration.

A major problem, according to Lawler, is the conservatism existing among compensation administrators who "seem intent on keeping their compensation programs up with, but never ahead of, the Jones in a sort of 'me too' behavior" (29, p. 21). Such conservatism has arisen from past failures when organizations tried incentive wage schemes and were "badly burned."

The extent to which these problems are real and handicap installation are unknown, however, since those writing on the subject of flexible compensation have not themselves installed such programs nor have they referenced any who have. Furthermore, it is not known whether any firm has attempted to utilize the concept of flexible compensation. Nor, is it known how practitioners as opposed to theoreticians, perceive the concept of flexible compensation. Neither is
it known just how to go about implementing flexible compensation. It is to these problems that the research in the following chapter is addressed with specific emphasis on flexible compensation for the nonexempt employee.
CHAPTER BIBLIOGRAPHY


CHAPTER III

ANALYSIS OF DATA

Introduction

Research is lacking on how many firms, if any, have taken the theory of flexible compensation as stated in journals and after-dinner speeches and actually applied such concepts to their compensation programs. While theoreticians have pointed toward certain areas of compensation as probable trouble spots, what problems have the practitioners found in their attempts at implementation? The purpose of this chapter is to develop empirical data on (1) the utilization of flexible compensation and (2) the problems as perceived by practicing compensation managers.

The Questionnaire

The questionnaire shown in the Appendix was mailed to 668 compensation managers or specialists representing 666 private industrialized companies having membership in the American Compensation Association (ACA). Where there was more than one member from a company listed in the ACA membership directory, the member with the highest corporate title was selected to receive the questionnaire. Due to one corporation having three subsidiaries listed in the American Compensation
Association Directory, questionnaires were sent to each of the three compensation managers. Otherwise, only one questionnaire was received by each company in order to avoid duplication of effort.

The questionnaire was segmented into five major parts consisting of a company data portion and four sections dealing with flexible compensation. All respondents were requested to complete the Company Data portion of the questionnaire which provided data on: the number of nonexempt employees, the percentage of nonexempt unionized, the number of unions representing the employees, the number of sites involved in the firm's operations, and the industry involved.

Section I of the questionnaire was designed to be completed by only those firms who were currently utilizing flexible compensation for their nonexempt employees. Section II of the questionnaire was designed to be completed by those firms who had either investigated or attempted flexible compensation for nonexempt employees. Section III was to be completed by those companies who had neither investigated nor considered flexible compensation for nonexempt employees. The final portion of the questionnaire, Section IV, asked all respondents if they knew of any other firm or individual who was involved with or conducting a study of flexible compensation.

The questionnaire was a single sheet so folded that the top, or outside segment, represented a covering letter with
the respondent's name and address typed on as a standard inside address. Within the letter, the respondents were promised that the data reported would be kept in confidence with no reference made to their organization unless permission was specifically asked for and received. To encourage participation, respondents were also promised that they would receive the results of the survey. Stamped, self-addressed envelopes were enclosed for return of the questionnaires.

The definition of flexible compensation provided in the questionnaire is as follows:

For this study, flexible compensation is defined as any compensation program which permits the employee to select from the various benefits and cash a plan tailored to his own need, limited only by his total compensation and those statutory provisions pertaining to his wages. In other words, the employee selects compensation options he values by dividing his total compensation among the benefits offered.

This definition and the finalized questionnaire were the outcome of critical evaluation by ten practitioners in the field of compensation who pre-tested the questionnaire.

Questionnaires were mailed out during the second week of May, 1972. July 1, 1972 was established as the cut-off date for the purpose of analysis of the questionnaires returned. By July 1, 1972, 423 questionnaires had been returned. Of these 423 questionnaires, 414 or 61.98 percent were useable for analysis. A summary of the questionnaire results were
provided for all those who returned questionnaires, except for three who stated that they did not wish to participate in the survey.

Analysis of the Questionnaire

The questionnaire was designed so that information could be collected on the number of firms that: (1) were currently utilizing flexible compensation (Section I); (2) had investigated or attempted flexible compensation (Section II); or (3) had neither investigated nor considered flexible compensation (Section III).

Firms Currently Utilizing Flexible Compensation

Seventeen respondents stated in Section I of the questionnaire that their firms were currently utilizing flexible compensation for their nonexempt employees. However, follow-up of these seventeen firms who responded as having flexible compensation revealed that none were actually providing flexible compensation as defined in the questionnaire. Rather than permitting employees to divide their total compensation between cash and fringe benefits, these plans provided for options only within plans such as early retirement at reduced benefit levels, additional insurance through employee contributions, withdrawal each year of 50% of profit sharing, voluntary contributions to company sponsored thrift and savings plans, and so forth.
Thus, of the 414 questionnaires used in the study, none can be classified as having true flexible compensation programs for their nonexempt employees.

**Firms Who Have Investigated Flexible Compensation**

Thirty-eight firms or nine percent responded in Section II of the questionnaire, stating that they had investigated but not attempted flexible compensation for their nonexempt employees.

Thirty-seven of the thirty-eight firms who have investigated the concept of flexible compensation completed the company data portion of the questionnaire. Eighteen of the firms investigating flexible compensation had between 1,000 and 5,000 nonexempt employees, while ten of the firms employed more than 5,000 nonexempt employees; four had between 500 and 999 nonexempt employees with the remaining five firms having less than 500 nonexempt employees.

Nineteen of the thirty-seven firms completing the company data section had no union representation. The remaining eighteen firms had the following breakdown on the number of unions: one union - 6; two unions - 3; three unions - 1; four or more unions - 8. Only six of the eighteen firms with unions had over fifty percent of their nonexempt covered by collective bargaining. Eight of the firms had less than ten percent of their nonexempt employees unionized; four firms had
ten-to-thirty percent of their nonexempt unionized while one firm had thirty-one-to-fifty percent unionized. Only five firms reported that they engaged in multi-employee bargaining.

The majority of the firms--twenty-four--had four or more domestic plant sites. While no one industry was dominant in investigating the concept of flexible compensation, the electronic industry was represented most often with five firms. The banking industry and the insurance industry each had three firms investigating flexible compensation; the pharmaceuticals and aerospace industries both had two representatives among those studying flexible compensation.

Table IV summarizes the responses of the thirty-eight firms who answered the question: "In what areas were you considering flexibility?"

**TABLE IV**

AREAS WHERE FLEXIBILITY WAS BEING CONSIDERED BY 38 FIRMS

<table>
<thead>
<tr>
<th>Area</th>
<th>Number of Firms Considering</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retirement Contributions</td>
<td>19</td>
</tr>
<tr>
<td>Stock Options</td>
<td>6</td>
</tr>
<tr>
<td>Special Vacation Arrangements</td>
<td>15</td>
</tr>
<tr>
<td>Company Housing</td>
<td>--</td>
</tr>
<tr>
<td>Company Automobile</td>
<td>4</td>
</tr>
<tr>
<td>Profit Sharing</td>
<td>11</td>
</tr>
<tr>
<td>Bonus Plans</td>
<td>10</td>
</tr>
<tr>
<td>Shorter Working Week</td>
<td>7</td>
</tr>
<tr>
<td>Education Allowance/Assistance</td>
<td>7</td>
</tr>
<tr>
<td>Medical Benefits</td>
<td>24</td>
</tr>
<tr>
<td>Life Insurance</td>
<td>32</td>
</tr>
<tr>
<td>Others</td>
<td>9</td>
</tr>
</tbody>
</table>
As seen in Table VI, life insurance was being considered most often as an area where flexibility could be applied by thirty-two of the thirty-eight firms who had investigated the concept. Medical benefits, with twenty-four, was the second most often considered area followed by retirement contributions and special vacation arrangements with nineteen and fifteen, respectively. Within the category of "others" the respondents listed the following areas: (1) financial consultations; (2) dental insurance; (3) vision insurance; (4) homeowners insurance; (5) automobile insurance; and (6) holidays.

Those who had investigated flexible compensation for their nonexempt employees were asked: "What was the ONE major reason for investigating or attempting flexible compensation?" Choices provided in answering this question were: attract employees, motivate employees, reduce turnover, prevent unionization, and others (please specify). While thirty-eight respondents completed this section, five chose a combination of reasons. The choices given by the thirty-three who selected one major reason are summarized in Table VII.

Motivation was the reason most often checked from among the response alternatives provided. However, the fifteen "other" responses which were written-in provide insight into some of the thoughts given to the subject by compensation managers. These "other" reasons were:
"Investigation of concept"
"Provide direct compensation of 'saved' 'indirect' costs"
"Employee satisfaction"
"Requested by employees"
"Personnel interest over past 5 to 7 years . . . continue to promote concept"
"More effective utilization of employee expenditures"
"It could be a better system for employees"
". . . meet varying employee needs"
"Cost of present plans"
"Increase employee interest in benefit programs, thus hopefully increasing general morale"
"Assure progressive benefits program"
"Modernize our approach"
"Fill employee's needs"
"Interest in keeping up"
"Best pay system"

TABLE VII
THE MAJOR REASONS GIVEN BY 35 FIRMS FOR INVESTIGATING FLEXIBLE COMPENSATION FOR NONEXEMPT

<table>
<thead>
<tr>
<th>Major Reason</th>
<th>No. of Firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Attract Employees</td>
<td>3</td>
</tr>
<tr>
<td>Motivate Employees</td>
<td>13</td>
</tr>
<tr>
<td>Reduce Turnover</td>
<td>2</td>
</tr>
<tr>
<td>Prevent Unionization</td>
<td>0</td>
</tr>
<tr>
<td>Other</td>
<td>15</td>
</tr>
</tbody>
</table>

Table VIII recapitulates the responses to the question asking: "What were the basic problems which have thus far prevented installation of flexible compensation?" The respondents were asked to check and briefly explain whether they found basic problems in legal, union, administrative, cost, or other areas. Thirty-six of the thirty-eight completed this section as two responded that they were still investigating and did not feel qualified to answer this question.
### TABLE VIII

BASIC PROBLEMS PREVENTING 36 FIRMS FROM IMPLEMENTING FLEXIBLE COMPENSATION FOR NONEXEMPT EMPLOYEES

<table>
<thead>
<tr>
<th>Problem Areas</th>
<th>Number of Firms Reporting</th>
<th>Summary of Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Legal</td>
<td>6</td>
<td>Internal Revenue Service (5); Fair Labor Standards Act (1); Liability for counsel (1)</td>
</tr>
<tr>
<td>Union</td>
<td>1</td>
<td>Contractual arrangements</td>
</tr>
<tr>
<td>Administrative</td>
<td>18</td>
<td>Controlling and handling increased work (7); communicating (5); complexity of costing-out options and providing equity (4); objections of insurance carriers (3); no centralized staff facilities (1); payroll complications (1); lack of personnel (1)</td>
</tr>
<tr>
<td>Cost</td>
<td>19</td>
<td>Costs from increased administration (9); possible costs from adverse selection (7); increased insurance rate due to smaller groups (4); added cash payout (2); question whether flexibility worth cost involved (1); obtaining top management approval of costs (1)</td>
</tr>
<tr>
<td>Other</td>
<td>12</td>
<td>Convincing top management (3); do employees know what is best? (2); lack of assistance from insurance and actuaries (2); difficulty in developing acceptable program (2); no competitive advantage at this time (1); interference from other projects (1); just not ready (1); looking for others who have tried flexible compensation plans (1)</td>
</tr>
</tbody>
</table>
As shown in Table VIII, nineteen of the thirty-six firms listed costs as a basic problem in implementing flexible compensation. Nine of the firms saw costs rising from the complexities and additional staffing required to administer such programs. Seven firms were concerned with adverse selection whereby only high risk individuals would be attracted to any given plan where costs are computed on experience. Similarly, four firms saw increased insurance costs arising from smaller groups. Added cash payout was listed as a problem by one firm while one respondent questioned whether the cost of flexibility was worth the effort involved. One firm saw top management's approval of added costs as a problem.

Administrative problems with eighteen firms were a close second to costs in number of responses given. Controlling and handling the increased work which flexible compensation would entail was the most frequent problem listed with seven responses. Communicating the flexible compensation program to employees and costing-out the various options to ensure equity were also common replies with five and four responses respectively. Objections from insurance carriers, the lack of centralized staff facilities, payroll complications and lack of specialized personnel were also mentioned as administrative problems.

Other problems respondents gave as being separate from the categories of legal, union, administrative, and cost were
somewhat more diverse. However, three firms stated that it is a problem to convince top management of the desirability of installing flexible compensation. Two firms questioned whether employees were capable of selecting plans which would adequately meet their needs. Lack of assistance from insurance firms and actuaries was seen as a problem. Other comments included statements that there was no competitive advantage at this time; difficulty in developing a program; interference from other projects; just not ready; and looking for others who have tried to implement such programs.

All thirty-eight firms answered the question: "Do you plan to utilize flexible compensation in the future?" Eighteen firms replied in the affirmative while nine stated that they did not plan to utilize flexible compensation in the future. Seven answered that they were unsure and undecided about the future implementation of flexible compensation. Two stated that they were still investigating the concept and as such had not reached any decision.

Only five firms stated in the questionnaire that they had discussed flexible compensation with their employees. Three of these stated that they had done so only informally and that the reaction was favorable. One firm stated that they had conducted seminars with employees on the subject.

Follow-up by telephone, personal interview, and correspondence with compensation practitioners revealed that TRW
Systems Group of Redondo Beach, California, is the closest firm to implementing flexible compensation for nonexempt employees.

A letter from E.K. Hamilton revealed that the following plan is being developed for implementation in July of 1973. Excerpts summarizing the "Employee's Compensation Choice System" are reproduced:

These plans will provide opportunities to increase employee benefits in Vacation, Hospital, Medical, Life Insurance and Accidental Death, and Dismemberment. All such increases will be priced in conjunction with insurance carriers and premium rates established to be passed on to the employees. Additional costs beyond the current level of company supplied benefits will be borne by the employee.

If employees wish to drop below the current level of company supplied benefits, they will have the opportunity of receiving the equivalent value in other benefits or cash.

All of the new plans are extensions of those currently in effect with some modifications. In any event, an employee will be able to retain his current benefits in their present form if he does not wish to participate in the choice plans. (3)

During the first year, employees will be able to choose options in the areas of vacation, hospital/medical, and life insurance. Under the vacation option, employees will be able to "purchase" an additional week of vacation with reduced pay or to "sell" one week and earn increased pay. With hospitalization and medical insurance, employees may choose between the current plan, a new low deductible plan or a new high deductible plan. The new, low deductible plan will be more expensive than the present plan and additional costs will be
borne by the employee. The new, high deductible plan is less costly and the difference in premiums between the present plan and the new high deductible one will be returned to those employees choosing the less expensive plan. The current life insurance plan of one and one fourth times salary which is company paid with optional one and one fourth times paid by employees will continue but the new plan will offer one-half annual salary as the minimum. Any additional insurance above the present company paid one and one fourth times salary (up to four and one half times salary) will be paid for by the employee. In addition, the employees can also purchase additional accidental death and dismemberment insurance to supplement that which is currently offered.

Another of the firms contacted in follow-up had been considering flexible compensation as a method for updating and expanding their compensation program. As of 1 July 72, subsidiary corporations were evaluating a confidential proposal to establish a new "two-tier design" concept to add dimension and flexibility to the benefit programs. While the author was provided a copy of the proposed plan, no mention will be made of the corporation's name since anonymity was promised. Tier I coverage of the proposed plan would provide all employees with essential basic protection. Tier II coverage would include supplemental benefits which employees could elect to satisfy their individual needs. The first tier
would be company paid with the second tier requiring employee contribution for any optional protection.

Voluntary plans under the optional coverage in Tier II would include extended dental and medical coverage, extended Life and Accidental Death and Dismemberment, Insurance, Personal Accident and Family Life Insurance, and a savings plan wherein savings would be matched up to a maximum of seven and one-half percent of the employee's salary.

In a telephone interview with the author, the compensation manager involved with the program was uncertain as to when this program would be implemented.

Follow-up also revealed that Cummins Engine of Colombus, Indiana, had been actively investigating flexible compensation with its nonexempt employees who were unionized (4). Small study groups of nonexempt employees which had been randomly selected met with consultants from Hewitt Associates to discuss flexible compensation and possible compensation alternatives which could be established. Unfortunately, wage and price controls combined with a strike terminated efforts of implementing flexible compensation. As of July, 1972, D. C. Sharp, Compensation Manager for Cummins Engine was uncertain as to when another attempt at flexible compensation would be made.

Educational Testing Service of Princeton, New Jersey is currently in the process of studying flexible compensation. Hewitt and Associates are also involved as compensation
consultants at Educational Testing Service and the random
selection procedure for establishing employee study groups
is also being utilized to explore the concept of flexible
compensation. Due to the fact that Educational Testing
Service did not answer the questionnaire and correspondence,
their actual status is unknown at this time. However,
according to the house organ, Educational Testing Service
hopes to become the first company with such a plan by
installing their program on January 1, 1974 (1).

Xerox Corporation in June of 1972 decided to study
flexible compensation and are presently involved in a re-
evaluation of the entire corporate compensation program.
While cautioning that the study is in its initial stage,
Ken Foster, Manager of Compensation and Benefits has indi-
cated that Xerox will probably "establish a core or base
line benefit package applicable to all groups and divisions
with optional adders" (2).

From conversations with compensation managers and con-
sultants in the field it appears safe to conclude that no
firm in the United States (whether they belong to the Ameri-
can Compensation Association or not) is currently utilizing
flexible compensation for its nonexempt employees. This is
also the same conclusion reached by the Council of Employee
Benefits (5). Several firms are currently involved in the
study of flexible compensation and those firms which appear
to be most serious in their investigations have been mentioned above, other firms were investigating flexible compensation, but only in a limited way.

Firms Who Have Not Investigated Or Considered Flexible Compensation

Section III of the questionnaire, for companies who had not investigated or considered flexible compensation, was answered by 359 or eighty-four percent of the firms participating in the questionnaire survey.

Table IX illustrates how these 359 firms answered: "Even though you have not seriously investigated or considered flexible compensation for your nonexempt employees, what would you anticipate as being the major problems should you attempt such an undertaking?" The respondents were asked to check and briefly explain whether the basic problems were legal, union, administrative, cost or other.

Administrative problems were viewed by a large majority, 248, as a major problem in implementing flexible compensation. Like those firms which had investigated the concept of flexible compensation, increased workloads was seen as the major administrative problem. Both categories--those who had investigated and those who had not--viewed communications as a problem under flexible compensation.

Unlike those who had investigated flexible compensation, those who had not investigated the subject ranked costs as a distant second to administration. However, like their
counterparts, those who had not investigated the subject saw costs increasing due to increased administration, adverse selection, and increased group plan costs due to smaller size. In addition, those who had not investigated flexible compensation saw costs rising from computer programs, counseling, and costing-out the program which were also seen as problem areas.

Unions were viewed as a problem by 131 firms or slightly more than one-third of the 359 firms reporting under Section III. This is not surprising since 211 of these 359 firms had nonexempt employees represented by unions. However, while eighteen of the thirty-six firms who had investigated flexible compensation had unions, only one of these firms listed unions as a problem due to contractual agreements. As can be seen in Table IX, complicated negotiations, the union philosophy of egalitarian treatment, and the difficulty of bargaining with several unions were seen as the major problem.
<table>
<thead>
<tr>
<th>Problem Area</th>
<th>Number of Firms</th>
<th>Summary of Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Legal</td>
<td>91</td>
<td>Internal Revenue Requirements (35); Fair Labor Standard Act (17); liability for counsel given (13); state and federal requirements (12); wage and price guidelines (9); Walsh-Healey and Davis-Bacon Act (3); miscellaneous (5)</td>
</tr>
<tr>
<td>Union</td>
<td>131</td>
<td>Complicated negotiations (35); against unions' philosophy of uniform egalitarian treatment (34); problem with several unions (10); union would object (8); unions originate demands and no demand for as yet (7); open new areas of bargaining (6); present contracts (4); unions are not progressive (3); union controls pension and medical plans (2); no explanation and miscellaneous (21)</td>
</tr>
<tr>
<td>Administrative</td>
<td>248</td>
<td>Increased workload on insufficient staff (43); records (38); communicating (37); problem coordinating and controlling (20); complexity (14); decentralized staff facilities (11); changes by employees (10); large number of employees (8); determining costs and pricing (5); equity (4); high turnover (3); time to develop (3); need computer (2); too small (2); no explanation (47); miscellaneous (15)</td>
</tr>
<tr>
<td>Cost</td>
<td>172</td>
<td>Costs for administration (34); reduced participation means smaller, more expensive group plans (18); increased staff (16); adverse selections (13); determining costs (10); loss of group discounts (9); insurance costs (6); computer program (6); counseling (5); controlling (2); more benefits (2); no explanation (45); miscellaneous (14)</td>
</tr>
</tbody>
</table>
TABLE IX -- Continued

<table>
<thead>
<tr>
<th>Problem Area</th>
<th>Number of Firms</th>
<th>Summary of Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Other</td>
<td>92</td>
<td>Employees are not able to plan properly, not astute enough to select best plan, etc. (16); dissatisfaction when bad choices are made (13); top management too conservative (10); no evidence of employees wanting the plan (7); present plan competitive (5); Do returns justify? (4); not practical and impossible (3); no trend seen (3); young want cash (3); finding insurance carriers (3); nonexempt suspicious (3); decentralized (3); miscellaneous (19)</td>
</tr>
</tbody>
</table>

Legal problems perceived by both groups were very similar. As with those who had investigated flexibility, those who had not gave the Internal Revenue Service as the major legal problem. Most firms just gave the Internal Revenue Service (IRS) as their explanation while others expanded their comments to include qualifications of group plans and obtaining IRS approval. Others, as seen in Table IX, listed federal and state regulations and wage and price controls as problems which, of course, can also include the IRS, especially wage and price controls. And, closely related to the Fair Labor Standards Act were comments on the Walsh-Healey and Davis-Bacon Acts. Liability for counsel given employees on benefits
and which option to take were seen by both groups as potential problems.

The comments under the "other" section in Table IX by firms who have not investigated flexible compensation are very similar to those made by firms who have investigated flexible compensation in Table VIII. The most frequent comment under this section was the expressed doubt as to whether non-exempt employees were capable and competent to select and devise compensation packages meeting the needs of dependents and the future. Both groups noted that convincing conservative top management was a problem. Firms who had not investigated the subject feared dissatisfaction by employees should they make incorrect choices. Common comments also included statements such as, there is no evidence employees want such plans; the present plans are competitive; no trend is seen; not practical and is impossible; young want cash; finding insurance carriers; decentralized operations, and the nonexempt are suspicious.

These comments under the heading of "other" in both Table VII and Table IX were, of course, unstructured and are not necessarily indicative of any widespread opinions or beliefs on the part of compensation managers. However, it is interesting to note that many of the criticisms noted in Chapter II such as paternalism, conservatism, "Me-tooism," and "things are alright unless employees complain" are represented in these comments.
Three-hundred-forty-six of the 359 firms answered the question: "Do you feel that your company may become involved with flexible compensation for nonexempt employees in the near future?" Of these 346 firms which have not investigated flexible compensation, twenty-six stated that they would become involved with flexible compensation in the near future. The overwhelming majority (320) answered that they did not plan to become involved with flexible compensation in the near future.

Only 244 of the 359 firms answered the question: "Which ONE of the following would you consider as being the major reason if and when your company were to install flexible compensation for its nonexempt employees?" The results are shown in Table X. Motivation, as with those who had investigated the concept, was given most often as the one major reason if and when flexible compensation would be utilized.

Under the choice of "other," twenty-two firms specified that the one major reason for using flexible compensation would be to individualize the compensation program. Twenty-four stated that they would consider flexible compensation only when it was necessary to do so to remain competitive due to a trend toward such compensation.
### TABLE X

**MAJOR REASONS IF AND WHEN 244 FIRMS WERE TO INSTALL FLEXIBLE COMPENSATION**

<table>
<thead>
<tr>
<th>Reason</th>
<th>Number of Firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Motivate</td>
<td>83</td>
</tr>
<tr>
<td>Attract Employees</td>
<td>34</td>
</tr>
<tr>
<td>Reduce Turnover</td>
<td>23</td>
</tr>
<tr>
<td>Prevent Unionization</td>
<td>18</td>
</tr>
<tr>
<td>Others (86)</td>
<td></td>
</tr>
<tr>
<td>Individualize Compensation</td>
<td>22</td>
</tr>
<tr>
<td>Competition and Trend Toward</td>
<td>24</td>
</tr>
<tr>
<td>Combination of Motivate, Attract, and Turnover</td>
<td>19</td>
</tr>
<tr>
<td>Better Utilization of Compensation</td>
<td>6</td>
</tr>
<tr>
<td>When Union Demands It</td>
<td>3</td>
</tr>
<tr>
<td>Employee Satisfaction</td>
<td>2</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>10</td>
</tr>
</tbody>
</table>

Others Involved With Flexible Compensation

Section IV of the questionnaire was the final segment of the questionnaire with only two sub-sections. All respondents were asked to list the name and address of any other company or individual who was involved with and studying flexible compensation. All respondents were also asked to make any comments or suggestions that they would like to make.

Eleven names were provided in Section IV as individuals or firms involved with flexible compensation. Out of these eleven, four had returned questionnaires so that seven new leads were provided for follow-up. Among these seven was
Eugene Hamilton of TRW Systems Group, Redondo Beach, California, whose name was mentioned twenty-seven times in Section IV and whose work with flexible compensation is well known by those in the field of compensation. Mr. Hamilton arranged a two-hour lay-over between flights at Love Field, Dallas, so that the author could interview him.

Also mentioned in Section IV as being involved with flexible compensation was Hewitt Associates, a management consultant firm. Discussions with practitioners revealed that Hewitt Associates are well known in the area of flexible compensation and have been directly or indirectly involved with every serious investigation of the concept that the author was able to discover. Thomas Wood and Ray Cole, partners in Hewitt Associates, granted the author a lengthy interview in the Deerfield, Illinois office. It was the opinion of these two gentlemen that serious problems would be encountered in obtaining data from practitioners—a prediction which proved true all too often.

Also listed as being involved with flexible compensation was Educational Testing Service, Princeton, New Jersey who made it public knowledge in June, 1972, that they were seriously attempting to install flexible compensation. Attempts to obtain information from Educational Testing Service proved unsuccessful.
Many respondents took additional time to make comments under Section IV. Twenty-one respondents remarked in various ways that they felt the study was worthwhile and were interested in obtaining a copy of the results. Five other respondents complimented the questionnaire design. However, not all respondents expressed this opinion as one remarked, after completing the questionnaire that: "This is a classic example of a useless survey." Eleven wrote remarks stating that they would start with exempt personnel first before they would ever attempt studying flexible compensation for nonexempt employees.

The study generated interest outside the American Compensation Association membership as the author was contacted by the Wall Street Journal, Pension and Welfare News and Time's new Money magazine. All requests for information were honored.

Summary

The American Compensation Association's 1972 membership list was utilized to mail 668 questionnaires to 666 firms in the private business sector of the United States. Four-hundred and fifteen useable questionnaires were analyzed and follow-up was conducted by telephone, correspondence, and personal visit. Out of the 415 firms replying, none are currently utilizing flexible compensation for their nonexempt employees. Thirty-eight firms had investigated the concept of flexible compensation. Of these thirty-eight firms, eighteen plan to utilize flexible compensation in the future. Seventeen
companies originally reported that they presently had flexible compensation but follow-up revealed that these seventeen had only options within plans and not true flexibility. Out of the remaining 359 firms, only twenty-six stated that they planned to utilize flexible compensation in the future. Discussions and follow-up with compensation practitioners leads to the conclusion that no firm is currently utilizing flexible compensation for nonexempt employees, either within or without the American Compensation Association.

Analysis of the questionnaire also revealed that numerous problems are anticipated with flexible compensation. These problems will be discussed in detail in Chapter IV.
CHAPTER BIBLIOGRAPHY


CHAPTER IV

PROBLEMS AND SOLUTIONS

Introduction

The major problems with installation of flexible compensation programs as perceived by the questionnaire respondents were reported in Chapter III and summarized in Tables VIII and IX. It is the purpose of this chapter to investigate these major problems to determine what solutions, if any, are available.

Legal Problems

Out of the thirty-six firms who had investigated flexible compensation and the 359 firms which had not considered or investigated the concept of flexible compensation, a total of ninety-seven saw legal problems involved with flexible compensation (see Table VII and Table IX). Forty response's listed the Internal Revenue Service as a problem. Also listed as problems in the legal area, and the number of responses for each, were: Fair Labor Standards Act (18); liability for counsel given (14); state and federal requirements (12); wage and price controls (9); Walsh-Healy and Davis-Bacon Acts (3); and miscellaneous problems (5).
It is important for firms to obtain approval from the IRS for their deferred compensation programs whether such programs are pension, profit-sharing or stock bonus plans. Approval by the IRS or qualification under Section 401 of the Internal Revenue Code has important tax consequence for both the employer and the employee. Qualification under the tax code means that the employer or firm can deduct contributions to pensions, profit-sharing or stock plans in the current year even though the employee does not receive any of the contributions until some future date. For the employee, qualification has the advantage of providing contributions which are not included in current income and on which taxes are not paid until the contributions are paid back at some later date. Furthermore, lump sum distributions at retirement or upon severance from qualified plans are given preferential tax treatment. Another important consideration is that benefits from qualified plans are exempt from estate taxes. Should deferred compensation plans be denied approval and qualification under the Internal Revenue Code, then both the firm and the employee suffer from unfavorable tax consequences.

One of the critical aspects of qualification of deferred compensation plans is Section 401 (a) (3) which states that in order to qualify the plan must have either:
(A) Seventy percent or more of all the employees, or eighty percent or more of all the employees who are eligible to benefit under the plan if seventy percent or more of all the employees are eligible to benefit under the plan, excluding in each case employees who have been employed not more than a minimum period prescribed by the plan, not exceeding five years, employees whose customary employment is for not more than twenty hours in any one week, and employees whose customary employment is for not more than five months in any calendar year, or

(B) Such employees as qualify under a classification set up by the employer and found by the Secretary or his delegate not to be discriminatory in favor of employees who are officers, shareholders, persons whose principal duties consist in supervising the work of other employees, or highly compensated employees (17, pp. 25, 183).

Taking subparagraph (A) in the above quote by itself would seriously restrict management in offering any flexibility in deferred compensation. However, the key is the "or" connecting paragraph (B) to subparagraph (A) since a plan does not have to meet the seventy percent rule if approval is obtained from the Secretary of the Treasury or his delegates. Approval under subparagraph (B) must not discriminate in favor of officers, shareholders, supervisory or highly paid employees. With nonexempt employees such discrimination does not appear to be a problem.

According to George Epps, Supervisor of Pensions and Profit Sharing Section, Internal Revenue Service (Dallas), the Internal Revenue Code's Section 401 was designed for traditional concepts of compensation (8).
Nevertheless, he feels that there is "a certain amount of flexibility within 401 to permit flexible compensation ... and it can be accomplished as long as the employer is willing to work it out." It was Epp's opinion that qualification of flexible compensation plans for nonexempt was not "too great a problem" (8).

Corporations would also be on guard to ensure that contributions paid into qualified profit sharing and stock bonus plans do not exceed fifteen percent of compensation paid in a taxable year (17, p. 25, 192.9; 25, p. 192).

Fair Labor Standards Act

In 1938, Congress passed the Fair Labor Standards Act (37) which has been amended so as to cover the vast majority of corporations engaged in interstate commerce. Under the Fair Labor Standards Act, employers must pay at a rate of not less than one and one-half times the regular rate of pay at which the employee is so employed for any work in excess of forty hours a week. Employers covered by the act must also pay at least the minimum wage which currently is $1.60 per hour. The regular rate of pay utilized for overtime computations must include all sums paid the employee except bonafide benefit plans providing old-age, retirement, life, accident, health insurance or similar benefits (37, pp. 1063-1065). The Wage and Hour Division of the Department of Labor is responsible for determining whether such benefit plans are
bonafide plans under the Fair Labor Standards Act. If such benefit plans are held to be bonafide plans, then the employer contributions to such plans are excluded from overtime computations. Failure to obtain approval of benefit plans from the Wage and Hour Division would mean that the regular rate of pay would be computed at a higher rate for purposes of overtime computations since additional overtime would be paid on the employers contributions to nonapproved plans.

Under the Fair Labor Standards Act, the minimum wage must be paid "free and clear"—contributions by the employer to benefit plans such as pensions, profit sharing, and insurance plans do not count toward the minimum wage requirement. Minimum wages and overtime payments must be made in cash or its equivalent. Lindquist of the Wage and Hour Division stresses the importance of paying the minimum wage and overtime as required by the Fair Labor Standards Act:

It appears to have been the clear intention of Congress to protect the basic minimum wage and overtime compensation required to be paid to the employee by Sections 6 and 7 of the Act from profiteering or manipulation by the employer in dealings with the employee. Section 3(m) of the Act and Subpart B of this part accordingly prescribe certain limitations and safeguards which control the payment of wages in other than cash or its equivalent. These provisions it should be emphasized, do not prohibit payment of wages in facilities furnished either as additions to a stipulated wage or as items for which deductions from the stipulated wage will be made; they prohibit only the use of such a medium of payment to avoid the obligation imposed by Sections 6 and 7 (18, p. 13577).
The reasonable cost of board, lodging, and other facilities closely related to board and lodging may be considered as part of the minimum wage when such items are customarily furnished to the employee (18, pp. 13577-13578).

The interpretations of the Fair Labor Standards Act are that the employee must receive cash or its equivalent equal to the applicable minimum wage which is currently $1.60 per hour. This in effect sets a base line, or a floor, for cash below which payments must not fall. For the nonexempt employee earning only the minimum wage, all flexibility must originate from within the benefit plans offered by the employer since the cash portion of his compensation cannot be redistributed. For those nonexempt employees who earn considerably above the minimum wage level, flexibility is possible within that portion over and above the minimum wage.

Approval of flexible compensation plans would have to be obtained from the Wage and Hour Division of the Department of Labor. While the ultimate decisions on interpretations are made by the courts, the Secretary of Labor and the Administrator of the Wage and Hour Division have the responsibility of administration and enforcement of the Fair Labor Standards Act (18, p. 13576). Interpretation and approval would have to be granted by representatives from the Wage and Hour Division.
When approached by the author with questions pertaining to flexible compensation, the Assistant Regional Administrator of the Wage and Hour Division in Dallas stated that he did not see any major conflict between the law and flexible compensation as long as the employee was paid at least the minimum wage and overtime was computed properly (29).

The proper computation of overtime is no less than one and one-half times the regular rate of pay for any hours over forty in a week. Thus, if a firm's job evaluation system assigns a value of $4.00 an hour to a position, any employee working in this position would receive an overtime rate of $6.00 ($4.00 x 1.5). How would overtime be computed under flexible compensation if an employee who was previously paid $4.00 chose to take only $2.00 in cash and applied the balance to other benefits? If overtime were to be computed on the new "regular" rate of $2.00, the overtime rate would now be decreased to only $3.00 ($2.00 x 1.5)--a considerable reduction from the overtime rate of $6.00 under the traditional compensation program. Needless to say, dissatisfaction with overtime could arise. Conversely, another employee in the same job classification might choose to take additional cash so that his new rate would become $5.00 per hour. Overtime computation for this employee would be increased from $6.00 under the traditional compensation program to $7.50 ($5.00 x 1.5) under flexible compensation.
This situation can be avoided by computing overtime rates on the dollar value assigned to each position by job evaluation. As such, both employees in the above example would receive $6.00 ($0.00 \times 1.5) an hour for overtime regardless of how they chose to distribute their compensation.

Walsh-Healy Act and Davis-Bacon Act

Closely related to the Fair Labor Standards Act are the Walsh-Healy Public Controls Act and the Davis-Bacon Act which are also administered by the Department of Labor in conjunction with the Fair Labor Standards Act. Under the Walsh-Healy Act, the Secretary of Labor establishes the minimum wage and overtime pay on an industry or partial-industry basis for those firms engaged in furnishing the Federal Government with materials, supplies, articles and equipment in amounts over $10,000. Minimum wages under the Walsh-Healy Act are established after hearings are conducted to review evidence upon the prevailing minimum wage for that industry. Usually these minimum wages exceed the minimum wage as determined by the Fair Labor Standards Act in which case the Walsh-Healy Act prevails. The same rules for computing the minimum wage applies to the Walsh-Healy Act contracts as under the FLSA so that the prevailing minimum wage must be paid in cash (28, p. 6040). This could possibly cause problems for a firm which implements flexible compensation prior to being covered
by the Walsh-Healy Act. Should such a firm later obtain a government contract subject to Walsh-Healy provisions, the cash wages could be less than those established for the industry by the Secretary of Labor. The possibility of the firm's entire wage structure being out of line would be remote, since the Secretary of Labor bases the minimum wage upon prevailing industry wages. More probably, the problem would be with those individuals who chose to receive a cash wage below the established minimum. Hopefully, the firm in this situation could request and receive an exception from the Department of Labor on the agreement that such employees receive the lower wages by choice.

The Davis-Bacon Act presents less of a problem since the Department of Labor permits fringe benefits to be combined with cash to satisfy minimum wages which are based upon the prevailing area wage rate. Under the Davis-Bacon Act, the exact minimum hourly rate established by the Department of Labor does not have to be paid as long as any combination of cash and fringe benefits equal or exceed the minimum rate. However, such fringe benefits must be approved by the Department of Labor as being a type of benefit which is a prevailing type within the area (28, p. 6047). Few problems should be encountered under the Davis-Bacon Act.
Liability for Counsel Given

Fourteen firms stated that they feared liability for counsel given employees concerning their compensation. Concern was expressed that employees who make what later become improper or unfortunate choices would seek relief through court action. Such fears are well-founded since there is precedent for recovery under tort action against the employer even though such action could not be sustained under theory of contracts. In Gedeman v. Anheuser Busch, Inc. (299 F. 2d 537) the estate of an employee was denied recovery under contract for certain death benefits but recovery was granted on the theory of torts. Referencing the Restatement of Torts (3) the court held the defendant liable for advice given the employee at an earlier date. That section of the Restatement of Torts which was relied upon by the court is set forth as follows:

522 INFORMATION NEGLIGENTLY SUPPLIED FOR THE GUIDANCE OF OTHERS

One who in the course of his business or profession supplies information for the guidance of others in their business transactions is subject to liability for harm caused to them by their reliance upon the information if

(a) he fails to exercise that care and competence in obtaining and communicating the information which its recipient is justified in expecting, and

(b) the harm suffered
   (i) by the person or one of the class of persons for whose guidance the information was supplied, and
(ii) because of his justifiable reliance upon it in a transaction in which it is intended to influence his conduct or in a transaction substantially identical therewith (1, p. 122).

The court in the Anheuser decision also relied upon Judge Cordozo's well-known opinion in Glanzer v. Shepard (135 NE at 275) in which Cordozo remarked: "It is ancient learning that one who assumes to act, even gratuitously, may thereby become subject to the duty of acting carefully, if he acts at all" (135 NE 276).

It can be seen from the law of torts that compensation managers could easily fall into the peril of giving advice which could later be used as a basis for court action. The solution to the problem is not to give advice but rather to provide information. Providing information rather than advice is a fundamental philosophy of flexible compensation as an attempt to move away from paternalistic compensation programs. With assistance from the legal staff, there should be little difficulty in designing information programs which avoid becoming advice. Furthermore, statements designed by the legal staff could be devised which would be signed by each employee as acknowledgement that choices were made independent of advice from any agent of the firm. It may be advisable to permit those employees who are too ambivalent to choose flexible compensation options the privilege of remaining under the old program to preclude later claims that advice was forced upon them in choosing options.
Wage and Price Controls

On August 15, 1971, under authority of the Economic Stabilization Act (Public Law 91-379 84 Stat 799) the President announced a ninety-day freeze on prices, rents, wages and salaries. On October 15, 1971, the President established the Pay Board to oversee and develop economic restraints.

Among the regulations on stabilization of wages and salaries the maximum general wage and salary increase to 5.5 percent of total compensation has been established. However, under the Economic Stabilization Act and Pay Board regulations, wage and salary controls do not apply to employer contributions for (1) pensions, profit sharing or saving plans which qualify for special tax treatment under the Internal Revenue Code; (2) any insurance plan; and (3) any disability or health plan. These exemptions were provided to prevent wage controls from inhibiting the establishment of new benefit plans or the liberalization of existing ones (44). As a general rule, employer contributions to these exemptions are not to be counted against the general 5.5 percent standard unless such contributions become "unreasonably inconsistent" with the general standard. The Pay Board has decided that contributions to the exempted benefit plans are not "reasonably inconsistent" with Pay Board Standards as long as contributions to such plans do not exceed 0.7 percent of total compensation. Any
contribution above 0.7 percent, unless exceptions are granted, are included within the 5.5 percent standard.

Nine questionnaire respondents felt that such controls would restrict and complicate installation of flexible compensation programs. In an interview with one compensation manager (who wished to remain anonymous), the Pay Board was given as one reason why flexible compensation was not pursued beyond the discussion stage. The compensation manager was attempting to convince the union to negotiate for flexibility with the new contract. But, the 5.5 percent guideline forced most of the wage increase into the exempted benefit areas leaving little flexibility in the contract for the small cash increase awarded under the agreement.

W. T. Coppenger, District Director for the Internal Revenue Service points out the problems involved with flexible compensation under the 5.5 percent guideline:

There is no prohibition against taking as much of the cash compensation as you wish and placing it in the form of deferred compensation such as stock options, profit sharing plans and pension plans. There is a limitation, however, on the amount that may be taken from deferred compensation and paid in cash.

The President has determined that in order to stabilize the economy and to protect the purchasing power of the dollar, it is necessary to stabilize wages, limiting the amount of money that may be spent. To permit immediate expenditure of money intended for deferred compensation would defeat that aim.

The increase in cash salaries would theoretically be limited to 5.5 percent annually. The qualified benefits (deferred compensation) would have similar limitations. Profit sharing, pension plans, and the
like are limited to 9.7 percent new increases annually plus 1.5 percent in "catch-up" if these benefits have not increased during the past three years (7).

In his final comment, Coppinger concludes that "We agree with the employers who have told you that stabilization regulations restrict flexible compensation" (7).

The problems foreseen under the Economic Stabilization Act's mandatory 5.5 percent guideline for compensation increases may have been only temporary due to the initiation of Phase III rules effective January 11, 1973 (36, p. 7). Under Phase III, President Nixon modified the Economic Stabilization program so that future wage standards will be self-administered under a quasi-voluntary program. "That is, business and workers will be able to determine by themselves what conduct conforms reasonably to the guidelines and will not be required to receive prior approval for their actions" (36). Thus, it appears that many problems foreseen under mandatory wage controls should be greatly alleviated under the doctrine of "conform reasonably." Additional time will be required for compensation managers to appraise the results of the revised stabilization program. But, the new stabilization program appears to be much less stringent and more compatible with flexible compensation.

State and Federal Requirements

Twelve firms listed state and federal requirements under legal problems without specifying what state and federal
requirements were intended. It may be assumed that these included those problems discussed above. Also, it may be assumed that the respondents also had in mind state regulations on group insurance, a definite area of concern for compensation practitioners.

All but ten states (which are mainly non-industrial) have enacted statutes modeled after either the 1917 or the 1946 National Association of Insurance Commissioners (NAIC) model bill for group insurance (12, 1-11). While there is often substantial deviation from the NAIC model bills, most states follow the NAIC model bill on the minimum number of lives to be covered within a group and the minimum proportion of the group which is to be covered. The minimum number of lives to which group life insurance is permitted in most jurisdictions is ten (12, p. 30). If the employee does not make any contribution to the group plan, then all states following NAIC guidelines require that all eligible employees be covered. Where the plan is contributory in that employees pay part of the cost, then a minimum of seventy-five percent of the eligible employees must participate. Even in those states which do not have statutes, similar rules are followed as sound underwriting rules by carriers providing group life insurance (12, p. 33). Also, most states set limits on the amount of life insurance which can be written.
Article 3.50 of the Texas Insurance Code provides insight into restrictions placed upon group insurance:

(1) (d) The amounts of insurance under the policy must be based upon some plan precluding individual selection either by the employees or by the employer or trustees. No policy may be issued which provides insurance on any employee which . . . exceeds Twenty Thousand Dollars ($20,000), unless two hundred percent (200% of the annual compensation of such employee . . . exceeds Twenty Thousand Dollars . . . in which event all such term insurance shall not exceed Fifty Thousand Dollars . . . or two hundred percent (200%) of such annual compensation. . . .

(3) (b) . . . Such policy may be placed in force only if at least 75% of the eligible employees . . . elect to make the required premium contributions and become insured thereunder.

(c) The policy must cover at least ten (10) employees at date of issue (43, pp. 77-78).

States may permit some flexibility in that classes of employees may be designated according to conditions pertaining to employment. In such instances, participation is based upon those eligible within the various classes (42, p. 247).

A solution to such statutes is to set a low, basic core of insurance which the firms themselves provide. This has the advantage of providing a basic core of insurance to all employees which would eliminate the concern of some compensation managers that employees would neglect insurance in favor of cash. Such a floor or base line approach could be established at a level where the firms feel assured that the employees and dependents are protected from adversity due to accidents, sickness, death, disability, and so forth. This
is the approach being considered by those currently investigating flexible compensation (i.e. see Chapter III).

An additional method has been devised by at least one insurance company to overcome some of the stipulations enforced upon carrier by state statutes (9). By establishing a special trust fund in Rhode Island, one New York insurance carrier is able to offer group insurance for as few as one employee and up to $50,000 of insurance. This permits firms to obtain group insurance either for fewer employees than statutes allow or in excess of statutory ceilings. While this arrangement appears best suited for the smaller employer and small professional firms, it would seem to permit flexibility even for larger corporations with special or select classes of employees, especially since the program also provides for group insurance along with group term insurance.

Unions

A total of 131 questionnaire respondents commented that unions were a basic problem in implementing flexible compensation (see Tables VI and VII). Only one response stating unions as a problem was given by those who had investigated flexible compensation. The two most frequently mentioned problems were that negotiations would be complicated (36) and that unions were philosophically opposed to individualized treatment of members (34). The other explained responses
were closely related to these two responses in that they dealt with union objection (8), unions originate such demands (7), opening of new areas of negotiations (6), present contracts (4), unions are not very progressive (3), and that unions control pensions and medical plans (2).

Complicated Negotiations

Flexible compensation will almost certainly complicate negotiations—at least initially. Even under present collective bargaining, each bargaining session is likely to result in an even bulkier contract than the one being replaced (5, p. 207).

While there is no way to escape the initial impact of flexible compensation upon collective bargaining, there are ways of alleviating the problem. Joint-study groups composed of both union and management personnel could resolve many problems prior to actually bargaining. Open-ended bargaining could be utilized to reduce the pressure of having to finalize all aspects of the agreement prior to set deadlines. Ultimately the individual firm must arrive at a decision as to whether complicated negotiations should be permitted to outweigh the prospect of a better compensation program.

Union Philosophy

The union philosophy towards flexible compensation would in turn influence the negotiations and subsequent administration
of the contract. If management is in favor of such a program but is faced across the bargaining table by union negotiators with a philosophical orientation opposed to such compensation, the negotiations and acceptance will be difficult. Conversely, union negotiators could be in favor of flexible compensation and find that management is opposed.

Just as attitudes by management differ on the subject, so do attitudes by unions. When requested to provide a position statement on flexible compensation, the assistant research director for the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO) replied:

I find it difficult to believe that a trade union would negotiate an agreement whereby its members would exercise an option as to whether the members would be covered by a pension plan or get an equivalent amount in case [sic], covered by a health and welfare plan or the equivalent in cash, etc. (27).

Newell of the International Association of Machinists and Aerospace Worker's research department states that: "It is certainly too early for us to take any type of 'official' position on it [flexible compensation]. It seems sufficient to indicate that we are aware of the phenomena and following it with interest. Anyway, in our type of democratic Union, the members covered by a particular contract would have to decide if this was their 'cup of tea'" (24). Newell is of the opinion that flexible compensation would best be applied to only that part of the package over and above a basic money
settlement since inflation forces members to be concerned with increased wages. And too, Newell notes, contracts often tie rate of pay to benefit levels. Some unions would oppose unlimited choice in the benefit area since their monthly dues structure are related to average hourly earnings. Continuing then, Newell adds:

Returning then, to the more likely situation where an employer has the option of how part of his total compensation is allocated, the advantages would appear to be: (1) The employee participates in the selection of benefits he feels are best suited to his or her needs; (2) the employer's contribution (and the Union's role in obtaining same) is more visible; and (3) the nature of the system requires more communication with the employees in order to assure that they understand the choices offered them. The Union's role in this communication could help to improve the Union's image in the eyes of the workers (24).

It is noteworthy that in this opinion, benefits are seen as being derived by all three parties—the employer, the employee, and the union. Each union, and even each local situation, would have to be reviewed before any conclusion could be drawn concerning philosophical attitudes of the unions involved.

Acceptance or rejection of flexible compensation in a situation governed by collective bargaining will be influenced by the relationship patterns existing between unions and management. Relationships, according to Walton and McKersie (45, pp. 185-190) can range along a spectrum consisting of "conflict" (denial of legitimacy of the other party; "containment-agression" (grudging acceptance of the other party);
"accommodation" (acceptance of status quo); "cooperation" (complete acceptance of each party legitimacy); and "collusion" (parties collude to violate laws). When the relationships consist of "conflict" and "containment aggression" there is a lack of trust with each side seeking to weaken or even destroy the other side. With "accommodation" there is an individualistic policy of hands-off and limited trust. Attempts to install flexible compensation--by either the union or management--under these relationships of "conflict," "containment-aggression," or "accommodation" would be difficult and probably impossible due to the lack of trust by the parties involved in collective bargaining. "Collusion" would not be conductive toward flexible compensation since it is based upon "symmetrical blackmail possibilities" (45, p. 188). Thus, the relationship pattern of "cooperation" remains as the one most likely to foster an atmosphere necessary for collective bargaining on flexible compensation:

This pattern is characterized by the fact that the parties willingly extend mutual concern far beyond the familiar matters of wages, hours, and conditions. Productive efficiency, the solvency of the firm, elimination of waste, advance of technology, employment security, and so on, are treated as matters of common interest.

There is likewise full respect for the other--its organization and officials. The union accepts managerial success as being of concern to labor; management recognizes its stake in stable, effective unionism. In as much as each has found areas in which the other can be instrumental to its own objectives, it is likely to act in such a way as
to strengthen the other organization or its leaders. Finally, there is a mutual trust and a friendly attitude between the parties generally (45, p. 189).

It is questionable whether negotiations for flexible compensation should be attempted unless such cooperation as described is present in a large degree. In the absence of a cooperative relationship, a climate of distrust and defensive behavior will evolve. Within a climate of distrust, communications become distorted and problem solving becomes more difficult (11, 21). Unless there is trust and a relationship of cooperation between the management and union(s) involved, flexible compensation should not be attempted.

It would appear advisable for joint study groups to be established, free from the pressures of time limitations which generally occur in contract negotiations. Once a program is settled upon, open-ended bargaining might be desirable until the program is running smoothly.

Unions Originate Demands

Firms who state that they are not involved with flexible compensation because their union has not originated the request for such programs are probably not ready to implement or negotiate flexible compensation. Those firms who rely upon the union to advance all proposals may lie upon the relationship spectrum somewhere other than in the area of "cooperation" (i.e. "conflict," "containment-aggression,"
Flexible compensation, as previously noted, should not be attempted in the absence of cooperation. Due to the nature of flexible compensation, those involved with implementation should be energetic, aggressive, and dissatisfied with the status quo in compensation. Those who wait for change to be initiated elsewhere do not appear philosophically oriented toward flexible compensation and, thus, should not attempt implementation.

Opening Up New Areas To Collective Bargaining

The fear that flexible compensation would open up new areas of bargaining is a weak argument. Section 8 (d) of the National Labor Relations Act (61 Stat. 136) holds that: "...to bargain collectively is the performance of the mutual obligation of the employer and the representative of the employees to meet at reasonable times and confer in good faith with respect to wages, hours, and other terms and conditions of employment...." This clause has been literally interpreted by the courts so that collective bargaining has been held to cover exceptional as well as routine matters affecting wages, hours, and other conditions of employment (25, p. 280).

Flexible compensation would not open any new areas for collective bargaining which at present are not already negotiable items. It would, of course, present new ways of distributing present compensation. But, no new areas would be
opened up for negotiations. It could be that in some areas of wages, hours, and conditions of employment particular unions have not chosen to bargain collectively under the National Labor Relations Act; however, they have the right to request collective bargaining.

Present Contracts

The responses that present contracts and that pensions and medical plans are controlled by the unions should not be serious impediments to flexible compensation since flexible compensation does not depend upon control by management for it to function properly. If both parties in the collective bargaining agreement are in favor of flexible compensation, then it would not matter. Only if management's desire to institute flexible compensation was unilateral would the union's control of the group plans be a problem.

Administrative Problems

The most frequently listed problem area by the thirty-six firms which had investigated flexible compensation and the 359 which had not investigated flexible compensation was administrative (see Tables VIII and IX). A total of 266 of these 359 felt that administration was a problem in any attempt at implementing flexible compensation. Controlling and handling the increased work was most often given as an administrative problem with a total of forty responses.
Record keeping and communications to employees were also listed frequently with thirty-eight and forty-two responses respectively. Other responses given were controlling and coordinating (20); complexities of flexibility (14); decentralized staffs (12); changes by employees (10); complexities of costing-out and controlling the program (9); large number of employees (8); equity (4); high turnover (3); objections of insurance carriers (3); lack of time available for development (3); lack of personnel and too small (3); need for computer (2); payroll complication (1); and no explanation and miscellaneous (62).

Increased Work, Records, and Communication

One hundred twenty responses were given mentioning increased administration from additional work, record keeping, and communications with employees. There is little doubt that administrative responsibilities will increase. The exact scope of the problem, of course, is unknown since no one has attempted to administer such a program to date. It is most probable that the administrative problems and expenses would be more than offset by a greater understanding and appreciation of compensation practices by the employees. The lack of appreciation and the common complaint that even the traditional approach to compensation is too complicated for the average employee may be due in great part to the present lack of
communication and educational efforts by compensation departments. Recent efforts by the First National Bank of Chicago to better inform and explain compensation options to their five thousand employees provides an example of how additional efforts at communicating pays dividends to the firm.

Initial communications on proposed changes in benefits were announced by the Chairman of the Board in a letter to all employees. This letter was pre-tested on various levels of employees to provide feedback on the clarity of the letter. Following the announcement letter from the Chairman of the Board, several articles were published in the house organ explaining the changes. Next, a relatively low-priced employee handout brochure which explained the benefit plans in simple language was distributed to all employees to serve as a temporary source document until group meetings could be conducted and individualized booklets could be distributed.

Group meetings were conducted by employees who were trained to give group presentations to fellow employees. Following the group meetings, individualized employee benefit statements were prepared and distributed. These individualized statements showed each employee the current status of his compensation package including a statement of his health coverage and a profit sharing projection estimating the individual's profit-sharing fund at age sixty (35, 30).
One result of these communication efforts was demonstrated in the attitude surveys conducted before and after the communications. Before the communication programs, only sixteen percent of the employees felt that they had an excellent benefit package and thirty percent stated that their compensation was either "fair" or "poor." Following the communication efforts, the attitude survey revealed that one-third of the employees felt that their benefits were "excellent" and those who felt that their benefits were either "fair" or "poor" decreased to slightly over ten percent (35, p. 20). Such a communication and educational attempt was not without its cost. Schultz of the First National Bank indicated that the total cost of communication and individualized benefit booklets was somewhat less than one percent of the total compensation costs for the corporation (30). This, Schultz felt, was a small price to pay for the advantages gained.

Computers have the potential of assisting management to overcome administrative problems and complexities involved with flexible compensation. Schuster et al (33) and Wolf et al (47; 48) provide insight into how computers may be utilized for implementation of flexible compensation. Computers are able to analyze effects of changes in such variables as taxes, age of employees, pay levels both from the employee's and the employer's vantage point. The individual, in order to elect between a number of alternatives, must be able to understand the financial implications of each
alternative. Schuster et al's Extended Program for Individual Compensation (EPIC) converts the computerized calculations into a "unit value" concept, facilitating employee understanding:

A "unit value" concept replaces dollars for discussion, computation, and communication of the program's components. To do this, a dollar value is equated to a unit at the time of initial offering. A unit begins with a value of $1.00. Thereafter, the system is related to this initial value in terms of unit effectiveness. For example, a unit of the organizational investment may be limited to three alternative forms of compensation: Form 1, 2, and 3. For a particular individual, a unit of the organization's money spent on alternative 1 might benefit him .75 units; spent on 2, 1.50 units; and 3, 1.25 units. This gives the relative financial information to help reach a decision. The conversion of unit values for employee information permits the individual to judge the relative value of alternatives in terms of current and future dollars. It places the purchase of compensation alternatives in light of something he can understand--the cost of the alternatives to him if he were to purchase a similar option with his own money.

Since tax rates vary between individuals relative to cash or non-cash compensation alternatives the evaluator formulas take into consideration the impact of taxes on each of the alternatives (33, p. 53).

Schuster recommends that employee compensation preferences be used to develop flexible compensation modules. Based upon these preferences, management can decide upon the number and composition of the modules that will be provided. "For example, module A might consist of 25.00 units of life insurance and 15.15 of sick pay; B, 18.09 units of contributions to stock savings plans and 23.00 in more liberal medical payments; and C might offer 35.75 units of vacation time" (33, p. 54).
In a similar fashion Wolf et al's COMSIM program utilizes an "efficiency index" which is based on the eventual economic benefit to the individual employee. "Direct cash payments will always have an efficiency index of 1.0 and all other elements are stated in relation to this base. Thus, an index less than 1.00 would indicate that the item being considered is less efficient than a cash payment..." (47, p. 27).

By providing an efficiency index the employees can compare the various compensation alternatives as they relate to each individual's situation due to tax laws, age, and income. If the module approach is utilized, the efficiency index will permit employees to compare the modules on an individualized basis. Even though employees may prefer one module or a series of options over others due to factors other than economic benefit, the efficiency index can provide additional information to be weighted by the employee in making a decision.

These computer programs can also generate documents which provide the individual employee with a summarization of his compensation package and its current value to him in terms of "unit values" or "effectiveness indexes." Such documents could also be designed so that any changes desired by the individual could be noted and submitted by the employee as a change notice at the appropriate and designated time.
The technology is available with present computers and Schuster et al have actually designed and tested their EPIC program (31). Wolf states that their COMSIM program has been utilized to project and simulate the effects of various deferred compensation choices and their tax consequences for executives (46). However, both Schuster and Wolf admit that they have not had the opportunity to utilize their programs in a broad flexible compensation program. Both Wolf and Schuster believe that computers can handle and manipulate the many variables encountered when considering flexible compensation. Hamilton of TRW agrees and states that his firm has the technology and also has enough computer programs presently on the shelf to handle flexible compensation programs (14).

Schuster states that most corporations can run such systems on their own computers. However, he recommends that such systems be run by an external agency to help insure the integrity of the information since a disinterested party would be handling compensation data instead of company personnel (33, p. 55). Use of external agencies would also permit those firms without computers or limited computer resources and staff to take advantage of agencies specializing in system development.

Hettenhouse (16, pp. 114-124) provides a method to determine the "effectiveness" or "unit value" of various forms of compensation without the use of computers. Hettenhouse
terms his methodology "cost-benefit analysis" which, according to him:

... my procedure boils down to finding the after-tax, present-value cost to the company of providing a given after-tax, present-value benefit to the executive. By repeating this procedure for each pay package, one can identify both the relative costs of providing a given reward and the relative rewards possible for a given cost (16, p. 117).

Following this procedure, Hettenhouse demonstrates how one can compute the cost-benefit rates for any type of compensation. For instance, if a fifty-five year old executive is to receive a $1,000 lump payment at age sixty-five with a tax rate at retirement of thirty percent, the present value (assuming a five percent per annum opportunity cost), of this compensation would be $434.03 (16, p. 117). Since the firm must pay $1,000 in ten years, it can deduct this against corporate income so that the after-tax value is only $520 (i.e. forty-eight percent marginal tax rate). Assuming a ten percent opportunity cost, the present value of the $520 is only $200.46. "On a per-dollar basis, this cost is roughly $0.46 for each dollar realized by the executive; that is, $200.46/$434.03 = $0.46" (16, p. 118). By computing the per-dollar costs for each compensation alternative, the relative desirability of each alternative can be compared.

While this example assumes an executive in the thirty percent tax bracket, the same procedure could be utilized for nonexempt employees. Job evaluation techniques utilized to
establish pay ranges of job classes would simplify computations for nonexempt employees since each job class would have minimum and maximum compensation levels. Thus, the computations for nonexempt could be somewhat routinized.

Costing-Out Compensation

Computers can also be utilized to determine the probable costs of flexible compensation programs. They have been utilized to simulate market conditions and optimize plant and inventory locations. Compensation need not be an exception and can simulate and provide rough estimates on the cost implications for a given compensation program (48, p. 44).

Costing-out compensation costs is simplified by knowing the preferences of the employees. While the ultimate extension of flexible compensation would be to offer employees an unlimited variety of items, this would tend to make management and cost controls of such programs unduly complex (38, p. 26). One way to simplify cost estimation, according to Taylor, would be to develop the "stages of man" approach:

Once we realize that a man's needs and desires change in a fairly predictable fashion over his working life—that each stage requires a different mix of straight salary, deferred salary, capital gains possibilities, standard fringe benefits, and special benefits—we can design the specifics. Careful research should enable us to set up, say ten basic packages. These would correspond approximately to each five year period in a normal man's business career and family development. One advantage of ten packages at five year intervals is that the difference between one package and the next would be relatively minor, whereas if we had only three packages the differences would be major. This will
help in administration, yet it will correspond more accurately to changing needs.
This does not mean that every employee has to accept each successive package on the preordained schedule (38, p. 27).

Taylor's "stages of man" approach is somewhat comparable to Schuster's module concept (supra, p. 106) which also establishes several basic packages.

Schuster (33, p. 54; 34, p. 38) claims that administration could be simplified by determining the preferences of those employees who are considered the most important to the firm and giving the desired performance. By responding to the needs of the satisfactory performers, such employees are rewarded as opposed to rewarding inappropriate behavior of unsatisfactory performances.

In either approach, it is necessary to determine the preference patterns or characteristics of employees so as not only to insure that needs are met, but to narrow the number of alternatives to be offered. Knowledge of the preference and the number of employees likely to select the alternatives permits computer simulation of probable costs and the before and after tax consequences to both the firm and the employees. From these projected costs management could then make a decision on just what could be offered to provide for flexibility.
Measuring Preferences

"Can employee preferences in regard to pay and benefit options be measured in a meaningful way" (23, p. 17)? Nealy believes that preferences can be measured (23, p. 24). It is relevant to note here that Professor Nealy has been retained for several years by TRW Systems Group which is the leader in the area of flexible compensation. Nealy has published data on the results of two methods which he has utilized in obtaining preferences from nonexempt employees. These two methods described by Nealy are:

1. The Pair Comparison Method. The form of presentation is exactly the same as in the standard psychological experiment. Each pay and benefit option is compared to every other one by considering only two options at a time. The subject must indicate the preferred option in each pair. Time-order error is avoided either by presenting each pair twice, first in one order, then in the other, or by presenting the pairs in one order to half the group, in the other order to the remaining half.

2. The Game Board Method. Each subject was given a hypothetical increase in compensation of $190 and was asked to indicate the manner in which he would "spend" this money on pay and benefits. Preferences were indicated by distributing monetary tokens among the various pay and benefit options. A subject could use all his money on pay raise or one benefit or he could purchase lesser amounts of several benefits. Subjects were furnished cost tables that listed the amount of each benefit that could be purchased for given amounts of money.

The subjects were provided with cost tables appropriate to their ages (23, p. 19).

The major differences between these two approaches are that in the game board method the employee has the option on
how he allocates the "increase" and that costs vary with the ages of the employees.

Nealy has published the results of three separate studies where the Pair Comparison and the Game Board methods were utilized separately or together (23, p. 19). Where the Pair Comparison and the Game Board methods were utilized simultaneously, the rank order correlation of preferences from these two methods for 132 hourly employees was +.93 significant beyond the .01 level (23, p. 23).

According to Nealy, the Pair Comparison method lends itself to being scaled meaningfully. In one group of 1,133 employees, the 120 possible triads of pair comparison options were 96.97 transitive, "giving us confidence that the pair comparison scale has ordinal properties" (23, p. 27). "Transitive refers to a situation whereby if a precedes b, and b precedes c, then a precedes c" (41, p. 28). If transitivity requirements are met, then the attributes or items can be measured on an ordinal scale (23, pp. 28 and 50). Therefore, according to Nealy, preferences for compensation can be arranged in a serial order so that the order of numbers assigned to a preference agrees with the actual property of preferences.

In addition to arranging preferences on an ordinal scale, it is helpful if compensation managers know the differences between the amount of preferences, or in other words, the amount by which one preference is preferred over the others. This would be of more value than only knowing that one item
is preferred more or less than another item. If the numbers assigned to preferences in the ordinal scale are so assigned that their differences reflect the size of the corresponding differences, the scale becomes an "equal interval" scale (41, p. 19). Use of paired comparison permits one to apply the Law of Comparative Judgment (13, p. 220) which converts attitudes to a quantative scale. Using Thurstone's Case V assumptions, the Law of Comparative Judgments can be used to determine if the discriminial dispersions on the scale are equal (13, pp. 220-221). Nealy found that the preferences of 132 hourly employees utilizing paired comparison and Thurstone's Case V were dispersed on an equal interval scale (23, p. 28).

Mahoney, working with managers, utilized the following three measures of preferences:

1. Managers were asked to indicate their preferred allocation of total compensation among the different forms. An expressed preference for an increase in one form of compensation required a balancing reduction in other forms since the managers were only permitted to reallocate their compensation, not increase the total received.
2. Managers were asked to rank the listed forms of compensation in preferred order for receipt of a small increase in total compensation.
3. A measure of strength of preference was obtained by asking managers to indicate the single form most preferred for each of three successive increases in total compensation (19, p. 137).

With a group of 450 managers, Mahoney found a correlation of +.66 between the second and third measures (19, p. 138). Mahoney, before utilizing the above approach, requested the
managers to allocate to each form of compensation the amount that they perceived the firm was spending on their various benefits. This approach permits the firm to investigate whether preferences are due to mis-perception, "e.g., a manager who underestimates pension contributions might be expected to want a greater proportion of compensation in the form of pension contributions (19, pp. 137-138). In addition, adds Mahoney, the accuracy of perceptions provide a means of evaluating the communications regarding compensation. If the perceptions are incorrect, then the compensation program may not be communicated effectively.

Schuster (32) provides a format for determining preferences worthy of consideration. Whereas Nealy utilized the Game Board for the relative strength of feelings toward alternatives, Schuster requested employees to demonstrate their feelings on the compensation components by indicating on a seven-part scale ranging from "very satisfactory" to "very unsatisfactory." To measure redistribution of compensation, Schuster utilized a somewhat modified "Game Board" wherein the employees were provided with the statement: "Assume that $1,000 of our organization's fund is spent in your behalf as distributed below. Are you satisfied with this distribution of funds between benefits and salary? Would you redistribute the funds? Indicate any changes you would make." Beneath these statements Schuster provided a modified game board:
Current Distribution | Your Distribution
---|---
Base Salary | $788
Retirement | 42
Vacation | 35
Stock Plan | 23
Group Medical | 19
Sick Leave | 16
Life Insurance | 4
Long-Term-Disability | 1
Holidays | 32
Legally Required Benefits | 40

$1,000

(32, p. 17)

In addition, Schuster asks these specific questions:

Specifically, what portions of our compensation package are most important to you?
Specifically, what portions are least important to you?
What one (or more) benefit(s) would you like to receive, not now offered by our organization?

(32, p. 17)

Schuster believes his study demonstrates that it is possible to identify perceived needs of employees:

A compensation program offering alternatives responsive to these needs could be designed. Options receiving strongest preference, both by being identified as "most important" and by getting positive redistribution emphasis, were the medical and stock plans, base salary and vacation. Those most mentioned as "least important" and getting negative redistribution were the retirement plan, holidays, and sick leave. We can assume then that given an option alternative, the general preference trend would be to spend available compensation monies on the first group of options at the expense of the second (32, p. 14).

The basic problem posed by Schuster (32, p. 9) as to whether there is a difference in changing compensation on a questionnaire and in reality remains unanswered. And, Thurstone and Clave's warning on attitude scales still appear relevant.
All that we can do with an attitude scale is measure the attitude actually expressed with the full realization that the subject may be consciously hiding his true attitude or that social pressure of the situation had made him really believe what he expresses. This is a matter for interpretation. It is probably worth while to measure an attitude expressed by opinions. It is another problem to interpret in each case the extent to which the subjects have expressed what they really believe. All that we can do is to minimize as far as possible the conditions that prevent our subjects from telling the truth, or else adjust our interpretations accordingly (39, p. 10).

In other words, we do not know the validity of instruments designed to predict preferences in the area of compensation. What is needed is a validity coefficient which would show the correlation between the choices on preference questionnaires and actual choices made when flexible compensation was actually implemented. Ideally, the validity of preferences obtained from questionnaires could be tested by permitting a group of employees to actually enroll in a flexible compensation program. The correlations between the preference questionnaires and actual choices could then be computed. The magnitude of the validity coefficient derived could then be utilized to predict the effectiveness of the preference questionnaires (2, pp. 105-131). However, this may be impractical in most situations due to legal and actuarial problems when only a portion of the employees are involved. Thus, until some future time when criterion-related validity of previously administered instruments are made available by practitioners who have implemented flexible compensation, the dilemma of prediction will exist.
While validity may pose a problem, the concept of reliability can still be utilized to minimize the danger that preferences on questionnaires will not correlate highly with actual choices. "Reliability refers to the consistency of scores obtained by the same individuals when re-examined with the same tests on different occasions, or with different sets of equivalent items, or under variable examining conditions" (2, p. 71). By computing the correlation coefficient for reliability one can generalize as to the amount of true variance in the trait (or preference) measured (2, p. 87). The higher the reliability coefficient, the less chance there is for results to be influenced by chance errors.

One method for finding the reliability of preferences is to repeat the same questionnaire or instrument on a second occasion (test-retest reliability). In this manner, the reliability coefficient would be the correlation between the preferences given by the same group of employees on two administrations of the preference questionnaires. In test-retest reliability, "the error variance corresponds to the random fluctuations of performance from one test session to the other" (2, p. 78). Thus, test-retest reliability measures temporal stability. If the time interval between the test and retest is fairly short, the employees may recall their former responses and answer accordingly rather than giving their actual preferences.
Alternate-form reliability can also be utilized whereby alternate forms of preference questionnaires are employed. While test-retest reliability indicates stability over time, alternate-form reliability indicates consistency of response to different forms. In order to be psychologically comparable, the alternate forms should be "parallel" (2, p. 81). This means that the tests should have the same number of items which are expressed in the same form, covering the same content, format, etc. A truly parallel alternate form may be impractical to develop for compensation preferences. However, by using several forms or types of questionnaires, a somewhat rough equivalent to alternate-form reliability can be computed. In effect, Nealy (22, p. 23) and Mahoney (19, p. 138) are providing us with a rough estimate alternate-form reliability by pointing out the correlations mentioned above. By correlating the preferences given using the paired comparison, ranking, and game board methods, one can obtain a rough estimate of alternate-form reliability. And, if all three forms are re-administered after some four to six weeks, the temporal stability and alternate-form reliability can be computed.

The research of Nealy, Schuster, and Mahoney provide compensation managers with the background and foundation for developing individualized preference questionnaires for their
organizations. It is important that any approach designed to gather data on compensation preferences include at least two techniques such as the paired comparison and game board in order to also develop alternate-form reliability.

If the firm is very small, it might be feasible to involve all employees in gathering preference data. Even in large organizations, all nonexempt employees might be asked to complete a mail questionnaire on preferences. While mail surveys can serve as a cross check on data obtained by other methods, the risk is such that results would not be predictive of how employees would actually choose options under flexible compensation. Without understanding the concept of flexible compensation, employees may think that they would prefer one item over another; but, when later making a choice with real economic implications, the employee may change his mind. Unreliable data obtained from the casual completion of a questionnaire received in the mail could have dire consequences for the firm. Rather, employees should give their preferences under conditions approaching realism.

In other words, the stimuli and cues evoking preference responses during the data gathering stage should be very similar to those stimuli and cues which will be present when all the employees select flexible compensation components. Unless the stimuli and cues are similar, employees at a later date may respond differently and thus select dissimilar
compensation alternatives. This also heeds Thurstone and Clave's advice (supra, p. 123) on minimizing the conditions which prevent the subjects from giving reliable data.

Data should be gathered from employees who give their preferences under conditions which would resemble conditions under which they would actually select components under flexible compensation. Such conditions would include discussions of flexible compensation, the economic implications of various alternatives including taxation, and the myriad questions which would arise. This realism can be generated most effectively in small group meetings with employees. Compensation managers should give thought to how they would communicate and implement flexible compensation if and when the decision were made to introduce flexible compensation into the organization. This same format should be utilized in obtaining preference data on what to base implementation decisions since maintaining uniform conditions helps reduce error variance and makes the results more reliable (2, p. 71).

Realism can be generated by making use of concepts such as Schuster et al's (33; 34) "unit value," Hettenhouse's (15) "cost-benefit analysis," or Wolf et al's (47; 48) "efficiency index." Information such as this provides an excellent approach for employees to visualize the actual impact of their choices. Needless to say, the expense of measuring preferences under "realistic" conditions can become
an important aspect in the investigation. Yet, this approach can have two positive results. First, the predictive value of data should be greatly enhanced. Second, thinking can be clarified by being forced to study the problems prior to making a decision at a later date. Working out procedures and developing data for small groups can yield experience which can be invaluable at a later date when all factors must be weighed in decision making. Recording or complete accounts of such group meetings should be kept to be used in refining future communications.

Sampling Techniques

On the assumption that small groups of employees working under conditions approaching realism is the better approach, how many employees and how should they be selected to participate in the feasibility studies on flexible compensation? Compensation managers can be guided in answering this question by random sampling techniques and the laws of probability demonstrated in basic business statistics texts. Basic decisions will have to be made by each compensation manager on the size or employee samples based upon the amount of sampling error which will be tolerated and the degree of confidence he desires. Also, standard error of the mean and standard error of percentage can be used to estimate
the reliability of the data obtained. The costs involved and resources available must also be weighed in determining the number of employees selected to participate in a preference study.

A satisfactory sample is not only adequate in size so as to permit estimation of the total population with some degree of confidence, but it is also representative. A large sample by itself is no guarantee that the results will be reliable. The accuracy of estimates derived from samples can be improved by insuring that the sample is representative.

Research by Nealy (22) and Schuster (32) indicate that there are several personal factors or demographic variables which influence the compensation preferences of nonexempt employees. Both Nealy and Schuster found that age, length of service, pay level, marital status, sex, and number of children influenced preferences. While Schuster (32) found that employees aged forty-eight and older had different preferences, Nealy (22) believes that there is a major difference between male employees at age fifty and over. Nealy also mentions home ownership, urban versus rural residence, and job attitudes as variables which influence compensation preferences. Both researchers also caution against assuming preferences to be stable between plant locations.
Since demographic factors can influence how employees perceive compensation, a single random sample could possibly result in an unrepresentative sample containing a disproportionate number of a given demographic variable. Such a possibility can be avoided by using a stratified random sample wherein each demographic variable or stratum would have its own random sample. By drawing a random sample from each demographic variable considered to be important, sampling error can be reduced. While the results of the individual stratified samples can be weighted to estimate the population, the results from each stratum or variable can also help management in predicting the impact on the organization from offering various options.

Computerized personnel and payroll records lend themselves to the development of stratified random sampling. However, because of computer or other limitations in obtaining random samples, an alternative would be to utilize systematic sampling where every kth employee, such as each 10th, 20th, ..., employee on a list, is selected. While systematic sampling is not random sampling in the sense that every employee has an equal chance of being included in the sample, the results should approximate those obtained with random sampling.

It is also possible that some firms may find it advantageous to employ multiple or sequential sampling
techniques where several samples are taken in sequence until it appears that the results have stabilized. This differs from single sampling techniques previously discussed where the size of the sample is determined prior to data collection. The taking of relative small samples in sequence until it is felt that estimates of the population can be made with the precision desired. The advantage of this approach is that it may be found that a much smaller number of employees need to be sampled than predicted under a single random sample approach. The savings could be considerable. This approach would tend to be successful when it is felt that preferences will be similar, possibly due to a rather homogeneous population.

Regardless of the approach utilized, great care and planning should go into the sample design. The tendency, perhaps, will be to rush hurriedly into gathering data so a decision can be made. This temptation must be resisted and management must be willing to invest heavily, if need be, at the preference gathering state to ensure that any decision reached will be a valid decision.

All possible techniques of statistical analysis should be performed on the results of the preference questionnaires to critically analyze the sample results. This, along with reliability data gathered some four to six weeks later, should provide data capable of reducing uncertainty. Should the
reliability coefficient turn out to be below .80, the results should be seriously questioned and re-evaluated to determine the causes for changes in perceived preferences.

Some firms may find the expertise of compensation consulting services helpful not only in the design of preference instruments, but in the analysis, interpretation, and projection of costs. Outside consultants can bring special skills to bear upon those areas in which the corporate staff may be weak or lacking. Consulting firms can also provide computer programs and computer time for firms with those needs.

For firms lacking necessary computer resources, external agencies could provide the necessary program to project costs of various options. This would permit those who do not have the necessary staffs and computer systems to still employ flexible compensation. Simulation of flexible compensation on equipment of external agencies would permit a firm to determine whether it should proceed with flexible compensation and thereby eliminate much of the guess work as to the cost, and it would determine whether or not they are capable of providing such programs.

Computers also reduce the problems listed by questionnaire respondents arising out of large numbers of employees and high turnover rates. Turnover, it is hoped, would be
reduced by flexible compensation so that employees would not only be attracted to the firm employing flexible compensation but also be retained and motivated by individualized compensation.

Equity

Four responses were given stating that providing equity would be a problem under flexible compensation. Equity does not appear to be a problem since equity or the philosophy of equal pay for equal work has been a major reason why traditional compensation practices have failed to respond to individual needs of employees. Flexible compensation has as its underlying philosophy the concept that individuals at different points in their lives will perceive differing combinations of cash and benefits as most equitable at a given time.

Insurance Carriers

Insurance carriers were listed by three respondents as problem areas since they would object to the concept of flexibility. It is not that insurance carriers are opposed to flexible compensation, but rather that there are certain principles or selection yardsticks which insurance companies use to measure eligible groups:
1. The group should be formed and maintained for purposes other than obtaining insurance.
2. There should be a steady stream of new entrants into the group.
3. Amounts of insurance should be determined by a method which precludes individual selection.
4. Safeguards should be established to produce a normal distribution of risks and to avoid the inclusion of an undue proportion of the total insurance in the group upon unhealthy lives, a few lives, or lives at advanced ages.
5. There should be a single administrative organization able and willing to act on behalf of the insured group.
6. There should be some party other than the insured member to pay a portion of the cost (12, p. 271).

There are two major reasons why insurance carriers impose such guidelines upon group plans--reduction of selection against the carrier and the expenses involved in insuring groups (12, pp. 31-49). Minimum size groups and minimum percentages are considered necessary to preclude the employer from obtaining insurance for the purpose of covering one or more impaired lives and also to prevent just those employees with impaired lives from enrolling. Likewise, by requiring minimum enrollments, carriers hope to increase the probability that the claims will be close to the expected. Also, since there are certain expenses of administration involved regardless of size, the per-case expense becomes less as the group becomes larger.

These guidelines work to protect the employer in the long run, since rates will eventually be based upon experience within his group. With proper information on the preferences
of employees, plans can be devised by carriers to satisfy the preferences and the needs of insurance carriers. One method would be to devise a base plan for all employees with optional plans provided over and above the base plan. This appears to be the technique being considered by those presently involved in serious investigation of flexible compensation (see Chapter III). Another approach would be to determine what programs would be preferred and at the same time actuarially sound.

Costs

Cost involved with flexible compensation was mentioned as a basic problem by one hundred ninety-one respondents (see Tables VIII and IX). Forty-three respondents stated that costs would arise from administration of flexible compensation. In addition to the response that administrative costs would rise, sixteen mentioned additional costs from increased staffing to handle the increased administration. Concern with actuarial problems whether stated as more expensive group plans, loss of group discounts, adverse selection, or insurance costs constituted the bulk of explained responses (58). Also mentioned were costs from computer programs, additional cash payouts, counseling, more benefits, and controlling the programs.
Administration

Costs are most likely to rise with flexible compensation. As one consultant stated: "We have never assumed that flexible compensation would be less expensive or have the same costs as traditional programs" (49).

Costs will vary between corporations depending upon various factors such as size, age, distribution of employees, and the extent to which the concept of flexibility is implemented. Baytos, noting the possibility of increased costs recommends that a firm proceed cautiously, following these steps:

Determine the need. Is the company experiencing problems in attracting and retaining the necessary personnel? Is some other approach likely to be more effective than a benefit smorgasbord? Can some advantages be gained through redesign and better communication of the present program?

Determine the potential. Which benefits will involve dollar amounts that will make them attractive additions to the smorgasbord?

Begin with those benefits that are easily understood by employees, are readily administered, and have identifiable costs. Examples of relatively simple plans for smorgasbord applications include deferred profit sharing plans and savings and stock purchase plans.

Try the program on a test group or on a simulation basis. Trial programs will help determine whether the company should commit itself to a full-scale program (3, pp. 24-25).
its particular goals" (3, p. 3). If present compensation practices are attracting, holding, and motivating people, the additional costs arising from installation of flexible compensation may not be economically justifiable. Organizational objectives could be furthered more effectively by application of resources elsewhere. The problem, of course, is measuring the effectiveness of compensation in achieving objectives:

Typically, not only must several objectives be considered simultaneously, but it is important to think about both short and long-range goals and about the health and viability of the enterprise. Thus, the concept of organizational effectiveness needs to be considered in analyzing and assessing personnel philosophy, policy, and practice (10, p. 4).

Compensation, just as any other subsystem in the firm, must make its economical contribution to the firm's objectives. If it can be shown that other subsystems would be able to contribute more to the "viability of the enterprise" by receiving that amount which is estimated to be the additional cost of implementing and maintaining flexible compensation, then the costs of flexible compensation may not be justifiable. In other words, the marginal returns from expending money for flexible compensation should at least equal the marginal costs. Otherwise, the firm is not optimizing the allocation of resources. The danger, of course, is that it may be difficult to measure the exact contribution that additional expenditures in compensation provide.
However, determining the costs should be easier than estimating the benefits of flexible compensation. Computer simulation of the impact of several courses of action should give a fairly accurate account of the potential costs of flexible compensation. Some costs may be found to be less than expected; conversely, others may be more expensive than planned on. Knowing and projecting costs can then permit management to accept and implement those areas which are economically feasible while delaying or revising other areas which are considered to be out of reach at present.

As noted previously, computer programs such as "EPIC" and "COMSIM" provide a method of simulating and projecting costs. Likewise, Hettenhouse's methodology permits analysis of costs without computer programs (supra, pp. 106-107). Using Hettenhouse's cost-benefit approach, it is possible to reduce total costs of compensation without any loss in benefits by those affected (16, p. 121; supra, pp. 106-107). It is possible using cost-benefit analysis to determine the cost efficiencies of any given compensation alternative. According to Hettenhouse, this method of compensation analysis lends itself well to flexible compensation and control of costs. While his emphasis is on executives, the concept should apply equally well with other employees. One can substitute the word "employee" for "executive" in the following:
Under this strategy, the company first decides how much cost it is willing to incur to reward a particular executive. The compensation administrator then generates a series of payment schemes, all at a cost equal to that established by the company, and presents this series and option to the executive for his consideration. The executive is then free to select the plan which best accords with his individual needs and tax circumstances (16, pp. 123-124).

This approach, Hettenhouse points out, is the reverse of most procedures followed "where the company first decides on a compensation reward appropriate for a given executive and then selects a compensation plan which minimizes the cost of providing him with that reward" (16, p. 124). The absolute cost of providing nonexempt employees with a given after-tax reward should, in most instances, be less than for executives in higher income brackets.

Using Hettenhouse's cost-benefit analysis, deferred compensation in the form of deferred profit-sharing and qualified pension plans are more desirable forms of compensation since the firm can provide the same after-tax benefit at a lower cost. This is due to the combined action of the corporation's constant marginal tax rate, the individual's progressive marginal tax rate until retirement at which time it generally drops, and the ability of the firm to usually earn a higher rate of return on investments (i.e. opportunity costs) (16, p. 122). If then, enough employees chose deferred compensation programs such as qualified pensions, profit sharing, and saving plans, flexible compensation could
result in lower total costs. Such a result may be wishful thinking since many employees may choose to take cash or group insurance plans which are less efficient. Nevertheless, the additional costs of cash and other less efficient compensation alternatives may be offset, at least partially, by choices in the deferred area.

Cost-benefit analysis provides the compensation manager a tool for forecasting probable costs. By knowing the preferences of employees, the results of flexible compensation, at least as simulated, may be surprising.

Start-up cost may be expensive since special educational efforts must be made to inform the employees and insure understanding of the options available under flexible compensation. This may not be as costly as expected since if we assume that it would be twice as expensive as communicating a traditional program (see page 101) the cost may be only two percent of total compensation. Staffing may also be an additional expense initially. After the program has been initiated, computer print-outs and computerized change notices attached to individualized reports should reduce the need for any significant increase in staff.

Actuarial Problems

Actuarial problems such as selection, loss of group discounts, higher group costs and similar comments were a major concern of respondents under the heading of costs.
Failure to control group plans would eventually lead to problems of increasing costs which would affect the efficiency of compensation outlays. The following excerpt from a confidential proposal represents the thinking of one firm which is currently proposing flexible compensation:

If limited numbers of employees are allowed to elect optional coverage as the need arises, the value of group protection would soon be lost. All the participants in the optional plans would be claimants, and the premiums would be necessarily reflections of this situation.

To avoid this situation the optional plans have been designed to include items of general appeal for large numbers of employees. They also include restrictions for enrollment. Under the recommended optional plans employees are allowed to enroll without evidence of insurability only on their first day of employment or during employer-designated open enrollment periods. Optional coverage and contributions may be discontinued at any time; however, the employee can re-enroll only with evidence of insurability or during the random enrollment periods. These precautions are considered necessary to guarantee the effective use of employee contributions and to assure the availability of continued low cost protection for the employee and his family (from a confidential proposal).

Thus, one method to combat adverse selection would be to place restrictions upon enrollment and require proof of insurability in those cases where it is deemed necessary. Also, a common element running through the proposed plan of those investigating flexible compensation on a serious plane is the offering of base plans designed to give coverage to all groups with optional plans added to the base or core plans. Knowing the needs and preferences of employees would permit
the optional areas offered to be appealing to enough employees to prevent individual selection against the carriers.

Pensions

Administration and control of costs of pensions under a flexible arrangement presents special problems. Costs of present pensions are indeterminate since real costs are the amounts of benefits to be paid out to future pensioners and the expenses of administration (26, pp. 88-89). Financing of the plans are either by arbitrary amounts or estimated amounts which are considered necessary to meet eventual costs of the plan. Three basic ways of providing for pensions are set forth by Fellers (26, pp. 146-147). One method would be to wait until the employee retires and pay him a pension of $100 a month. Since he should live fifteen years, the firm would pay a total of $18,000. A less expensive method would be to set up a fund for the employee so that the fund plus interest would be sufficient to pay the $100 monthly pension. Based on a three percent increase, only $14,600 would be required to purchase an annuity—a sizeable saving. Yet, another method would be to make payments into the fund before the employee retires so that these payments and interest will have accumulated to the same $14,600 noted above. Assuming three percent interest and a period of thirty years, only some $9,000 would be required to provide the same benefits as $18,000 in the first example or $14,600
in the second instance. "Consequently, this factor of interest, that is made possible by building a fund, can have considerable effect on the cost of the pension benefits" (26, p. 147). In addition, by qualifying the plan with the Internal Revenue Service, tax deductions are available which may result in actual costs of some fifty cents out of each dollar contributed to the fund. Also, the employee benefits from not having to purchase an annuity in the open market with his after-tax income.

The employer may find that flexible compensation will, in many instances, force him into providing more contributions for the pension funds should only older employees desire to obtain pensions; i.e., a situation similar to $14,600 as opposed to $9,000. It is noteworthy that those firms who have investigated flexible compensation from a positive approach did not mention or include pensions as part of their proposed flexible compensation programs (supra, p. 69). It is also likely that the current congressional interest in pension reform in the area of funding, vesting and portability is causing employers to avoid drastic changes in pension benefits (40, 4). Proposed reform of private pensions under the Javet-Williams Bill (Retirement Income Security for Employees Act) is aimed at three areas: (1) ensuring that more people, in the future, get benefits to which they are entitled; (2) improving vesting provisions; and (3) providing insurance for funds (40, p. 60). In view of the current climate, many
many firms may decide to stay away from flexibility within the pension area, at least until the extent of federal involvement is determined.

Nevertheless, pensions do lend themselves to flexibility since underwriting laws do not require that minimum percentages of employees participate. Most insured pensions customarily provide for seventy-five percent participation or minimum groups of twenty-five merely to attain economy of scale. Uninsured funds, of course, do not require participation minimums. Qualification for tax deductions does not require that all employees be covered and there is considerable discretion permitted on classes of employees as long as there is no discrimination in favor of officers, stockholders, or high salaried employees.

Some firms may find it advantageous to include pension benefits as part of their flexible compensation programs. It would appear prudent to develop or switch to insured plans, with individual annuities being vested in line with the proposed Javet-Williams Bill; i.e., in fifteen years. Individualized insured annuities for both employee contributed funds and those by the employer would also tend to satisfy complaints on vesting and portability. Actuarial problems necessitate control of age groups selecting pension benefits. As such, it may be more practical to provide a base or core of pensions for all employees with options available to acquire additional amounts of retirement benefits.
This approach would avoid bad publicity should an employee be denied a pension later on in his career due to age. The management of TRW is of the opinion that retirement pay is "too important to be juggled around" and would not be changed even with flexible compensation (6, p. 22).

Additional Cash Pay Out

Additional cash pay out was listed as a problem under the heading of costs. If one assumes that all employees will select to take cash over benefits, then cash pay out may increase greatly. This may not be the case as the actual cash pay out over and above that of a traditional plan will perhaps be influenced by the firm's particular age mix. Even though the employee takes home more pay, it does not necessarily follow that the firm has spent more money on compensation. As an example, assume a thirty-five year old employee under a plan similar to that discussed on page sixty-six is earning $10,000 a year and decides (1) to work an additional week rather than taking all his vacation; (2) to change his hospitalization to a high deductible one which costs the firm less; (3) reduces his life insurance to one-half his salary. By choosing to work an extra week the employee can convert a week of vacation into $192.00 or an additional $3.70 a week when prorated over the year. The choice of the high deductible health insurance may save his firm $5.00 a week which is passed on to the employee (6, p. 22).
By reducing his life insurance, the firm saves some $0.85 a week which is passed on to the employee (6, p. 22). Thus, by working an additional week, choosing a high deductible health insurance, and reducing his life insurance, the employee can increase his weekly pay by some $9.55 (i.e. $3.70 + $0.85 + $5.00). Of this $9.55, $5.85 represents only a transfer of funds from insurance carriers to the individual employee. The $3.70 a week is an increase in cash pay out in the sense that the employee is recovering more money from not taking all his vacation. However, in theory the firm would have to pay a vacation replacement the equivalent of $3.70 to carry out the tasks when the employee takes his vacation. As such, the additional cash pay out could be less than expected. Should a majority prefer cash over certain benefits, it can be argued that those benefits were not desired nor motivating employees to begin with and were a "waste" of money. It is possible that, due to the mix of employee preferences, total cash pay out may remain fairly constant under flexible and traditional systems.

Other Problems

Other Problems (see Tables VIII and IX) mentioned by the questionnaire respondents were wide ranging. However, two of the firms which had investigated flexible compensation and sixteen of those firms which had not, mentioned that employees are not able to plan properly or they questioned
the ability of nonexempt employees to provide for the future or choose properly. Sixteen of the firms were also concerned that there would be employee dissatisfaction when the employees determined at a later date that they had made incorrect choices. Three firms which investigated flexible compensation, and ten of those which had not investigated the concept, listed problems with top management's acceptance of such programs. Also mentioned more than once as a problem were the following: no evidence that employees desire such a program; the justification of returns; no trend toward such a program—so no reason to be concerned with it; finding insurance carriers; suspicious employees; decentralized locations, and younger employees wanting cash. The latter comments pertaining to the younger employees desiring cash were surprising, since flexible compensation would permit the younger employees to choose additional cash in lieu of other benefits.

Ability of Employees to Select Proper Plan

The statement that employees lack the ability to select suitable plans or to prepare for their needs smacks of paternalism. As one compensation manager remarked on the subject, "...paternalism is alive and doing well." The vast majority of nonexempt employees do not have to worry about the same tax consequences as executives in the $75,000 plus category who may need professional tax counseling. The
choices and the impact of such choices appear to be direct and apparent in the realm of nonexempt compensation. It does not appear that nonexempt employees would have to have super-intelligence to make decisions concerning compensation. "There is substantial evidence that the potentialities of the average human being are far above those which we typically realize in industry today" (20, p. 54).

Top Management Acceptance

A more serious problem is the possibility that top management will be opposed to any such radical revision of compensation practices. Top management support is necessary for implementation of flexible compensation. According to Wood of Hewitt Associates, the best way of determining whether a firm is serious about flexible compensation is to inquire about the corporate commitment toward flexible compensation. If there is not top-level commitment, says Wood, the chances are that they will not implement flexible compensation (64). Changing corporate philosophy may be an impossible task until several firms have taken the initiative and have demonstrated that flexible compensation is a workable concept. Once flexible compensation has been demonstrated as having merit, attitudes of conservative managers may change in favor of flexible compensation.
The first course of action designed at implementing flexible compensation should be the attaining of top-management approval of a program to investigate the feasibility of installing flexible compensation. Eventually, top management, most likely the president, would be required to go before the Board of Directors of the corporation to defend such a departure from traditional compensation policies. Unless the president, or his spokesman before the Board, is committed to the concept of flexible compensation, then there would appear to be little hope of ever achieving implementation or even an objective feasibility study.

Some management, like TRW, Xerox, and Cummins Engine, appears ready to experiment and test new ideas. If a compensation manager works for such a firm, his job of "selling" flexible compensation is easy. Convincing other managers that flexible compensation should be investigated is a greater challenge and may be the only insurmountable problem encountered.

Proposals to top management should include requests for adequate funds and the staffing of a project manager so as to prevent the study of flexible compensation from becoming encumbered with day-to-day operating problems.

Employee Dissatisfaction

Concern that employees will become dissatisfied at a later date can be a real problem. Despite the fact that the
choice is made by the employee, it is likely that some employees may choose to blame the firm for any shortcomings. Hopefully, by providing the information and communicating the possible advantages and disadvantages of various alternatives, employees as a whole can make educated and rational choices. Use of base programs designed to cover basic needs can reduce the problems of employee dissatisfaction. Utilization of flexible compensation with base programs can also simplify flexible plans and thereby increase acceptance.

Miscellaneous

The fact that employees have not asked for flexible compensation does not necessarily mean that they would not prefer it to traditional compensation. The question as to whether or not flexible compensation is justified, based upon its ability to provide returns to the organization, is certainly a critical question and remains to be answered. The statement that there is no trend toward flexible compensation is representative of the criticism that compensation practices are built upon "me tooism." Because the young may want more cash, it appears that flexible compensation provides a solution to this problem. Finding insurance carriers, suspicious employees and decentralized locations appear to be minor problems.
Conclusion

The objective of this chapter was to review what alternative solutions, if any, were available to the problems of flexible compensation as set forth by respondents to the questionnaire. With the exception of Pay Board Regulations, there appear to be solutions available for all the problems listed by American Compensation Association members. Pay Board regulations do not nullify flexible compensation, but restrict the amount of cash which can be taken in a given year. Solutions to the other problems may be merely practicable rather than practical in many instances--only empirical data will determine whether the problems can be solved in a pragmatic manner.

One problem, which can only be answered after actual experience is gained, is the "problem" of unions. Not enough is known to-date, nor is there sufficient evidence to indicate just how unions would react when confronted with flexible compensation at the bargaining table. As previously noted, the philosophies of various unions are ill-defined.

It would appear that "conservatism" as opposed to "liberalism" is an underlying problem in the field of compensation. A pessimistic and conservative compensation manager can certainly find a plethora of excuses for not pursuing flexible compensation. Conversely, a liberal or optimistic compensation manager usually can find reasonable solutions to the problems confronting implementation.
Flexible compensation will most likely be evolutionary in development, with initial programs being designed around core or base plans which provide greatly increased flexibility over traditional programs, but less flexibility than ultimately possible. As experience is gained, greater choice will be granted employees until eventually base or core programs will be discarded. The year 1973 may be the beginning of the evolution.

The author agrees with Wood who stated: "We have investigated every aspect of flexible compensation and have found no problem which can not be solved" (49).
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CHAPTER V

GENERAL GUIDELINES

Introduction

The objective of this chapter is to set forth general guidelines which would assist a compensation manager in developing flexible compensation. These guidelines are general in nature and are designed to serve as strategy rather than a step-by-step tactical approach for any given firm.

The guidelines are presented in two stages: (1) investigation into the feasibility and (2) the actual implementation.

Feasibility Study

Figure 2 provides a network analysis or a logic chart of the major steps involved with the investigation into the feasibility of flexible compensation. As indicated in Figure 2, the author envisions eleven major events which must be performed in determining the feasibility of flexible compensation for a given firm. The eleven events outlined in Figure 2 are briefly summarized following the diagram.
Fig. 2--Investigation of flexible compensation
Event 1: A corporate decision is made to investigate flexible compensation. It appears advisable to appoint a project officer whose sole responsibility is investigating the feasibility of flexible compensation. Unless the project officer has the support of top-level management, the study may suffer due to lack of interest and cooperation from the various corporate sections which will eventually be drawn into the investigation. The project officer preferably should have no preconceived opinions as to the feasibility of implementing flexible compensation.

Event 2: Efficiency indexes (5, 6) or unit values (7, 8) which permit employees to judge the relative worth of compensation options in terms of cash are developed. Efficiency or unit value indexes must be developed prior to administering preference instruments to the employees. Unless employees can visualize the economic impact of their choices on a preference instrument, the element of realism is lost. Without some form of index to convert options into a cash equivalent, employees may change their preferences considerably at a later date when they are choosing for "real." It appears that such indexes are mandatory to help ensure that preferences of the sample closely resemble the preferences of all the employees.

Event 3: Instruments are developed to gather compensation preferences from a sample of employees. Nealy's (3)
Game Board and Pair Comparison techniques can be utilized in developing preference data. Schuster's (4) modified Game Board and questionnaire along with Mahoney's (1) questionnaire approach provide additional methods which can be adopted to a given firm.

The development of these instruments to measure preferences is a critical aspect of the investigation since the data collected from the completed instruments will be utilized to predict the impact of flexible compensation upon the firm. As such, it is prudent to develop several types of instruments to provide as much data as possible and to also yield rough estimates of alternate-form reliability. Nealy's (3) Game Board and Pair Comparison techniques, Schuster's (4) modified Game Board and questionnaire and Mahoney's (1) questionnaire approach provide the methodology which can be adapted to the individual firm.

Event 4: A random stratified sample of employees is elected to obtain data on compensation preferences. Random samples permit one to utilize the laws of probability to estimate the reliability of the data. Stratifying the sample according to demographic variables such as age, length of service, pay level, marital status, sex, and number of children (2; 4) help make the sample more representative.

Event 5: The sample of employees are broken down into small groups for introduction to the concept of flexible
compensation and how to utilize efficiency or unit value indexes. Once the employees are familiar with the concept of flexible compensation, they are then requested to complete the preference instruments which have been developed to measure preferences on compensation. Some four to six weeks later, the preference instruments should be re-administered to at least a portion of the sample employees to determine the test-retest reliability of the instruments.

These small group meetings can also be utilized for improving the procedure which is used in communicating flexible compensation to employees. As such, notes and recordings of the meetings should prove helpful.

Event 6: Having obtained preference data from the sample group of employees, the analysis of preferences can begin. If the preferences from the various instruments correlate highly and if the re-test results also correlate highly, then it can be assumed that the instruments are reliable. If, however, the results do not correlate to a high degree, the instruments should be redesigned before proceeding further.

Analysis will reveal the preferences of employees by age, sex, marital status, number of children, and other such demographic variables.

Event 7: With data gleaned from preference instruments, insurance carriers can be approached for information
concerning costs and cooperation in designing various programs desired by employees. By providing insurance carriers with actuarial data and preference data of each demographic stratum they can plan and devise programs to satisfy the employees preferences in the area of insurance. Initial feedback and rough estimates of possible programs and costs are then used to finalize potential flexible compensation programs.

Event 8: Preference data may indicate that information in addition to that supplied by insurance carriers must also be obtained. It is possible that additional information may be required from banks, the Department of Labor, the Internal Revenue Service, the Security and Exchange Commission, relevant state agencies such as labor and insurance departments, and perhaps even car leasing firms and day-care centers.

Event 9: With information now in hand concerning what programs are possible, various programs can be devised. At this point, basic policies may have to be made concerning what types of programs are compatible with corporate philosophies. For example, it may be decided that all employees should be provided with a base or core plan of insurance as opposed to having complete flexibility in insurance coverage.

Event 10: After devising the various options, simulation is conducted to determine the impact upon the firm should any given option be offered as part of a flexible
compensation program. By changing variables and assumptions, computer simulation can generate estimates on the cost of offering any given option to employees. For firms without the necessary computer resources, external agencies can provide the necessary programs to project costs.

Event 11: After weighing the present and future costs and the disadvantages versus advantages of flexible compensation upon the firm, a decision on implementation is made. However, cost projections for flexible compensation alternatives should be compared not only to present compensation costs but also the projected future costs of the present conventional program. At this point in the cost study, the benefits anticipated from flexible compensation must be taken into consideration and applied as a cost offset to the increased costs of flexible compensation. Assuming that flexible compensation will increase costs, will the expected, theoretical benefits of increased motivation, job satisfaction, increased efficiency, and lower costs in attracting and holding employees, partially or wholly offset the additional investments in compensation? Resolving this question will perhaps be the most difficult and nebulous aspect of the research. Among the criteria utilized will certainly be the effectiveness of the present program in attracting, holding, and motivating employees. If the benefits to be gained by using flexible compensation do not outweigh the costs, then the decision to
implement should be withheld. It is possible that the same results could be obtained more economically by redesign of the present program.

The decision reached does not have to be an "all or none" type of decision, however. It is possible that only those portions which appear to be most beneficial from a cost-benefit criterion should be offered. It is also possible to design "option modules" as suggested by Schuster et al (5; 6) as a way to derive the benefits from flexible compensation and still control the costs involved. A more conservative approach would be to gradually evolve into flexible compensation, beginning with the less complicated and gradually evolving into the more complex programs as experience and costs permit. Perhaps the ideal situation would be to implement flexible compensation within a small and separate division or subsection of the firm to gather actual cost and operational data. However, the risks involved from having to possibly withdraw the program, or being forced to extend the program prematurely to the remainder of the firm to avert charges of favoritism, should be considered in such plans.

Implementation

If the decision made to implement flexible compensation is affirmative, a series of events must be set in motion to finalize and introduce the concept. Figure 3 illustrates
Fig. 3--Implementation of flexible compensation
the basic network analysis for the implementation stage.

Event 12: The official decision is made and plans are begun to implement flexible compensation.

Event 13: At this point, it becomes necessary to finalize the flexible compensation program into the exact format desired. Once the program is finalized, the stage is set for four events--14, 15, 16, 17--to occur simultaneously.

Event 14: Negotiations with insurance carriers are completed, leading to flexibility in the health and life insurance areas.

Event 15: Administrative and computer programs are established and made ready. The computer program should provide each employee with an individualized statement illustrating his present compensation and the efficiency or unit value index of each component. In addition, the efficiency or unit value of the options available under flexible compensation should also be given. This same computer document should also serve as a change document which can be used to show what options the employees have chosen or may wish to choose at a later date.

Event 16: In order to avoid legal problems, especially in the area of "advice to employees," the corporate legal staff should thoroughly study and approve the finalized program. It may be that the computer document can be designed
to include a statement relieving the corporation of liability as to advice and tort liability. The legal staff should be very active in all phases of the program at this point.

Event 17: Approval from federal and state agencies must be received prior to proceeding further with implementation. The federal agencies most likely to be involved are the Internal Revenue Service for qualified plans and wage controls and the Department of Labor for the Fair Labor Standards Act, Walsh-Healy and Davis-Bacon Acts. Some states will also have state insurance boards and departments of labor which must approve nonexempt compensation programs.

Event 18: Communications can now begin in order to introduce, inform, and educate employees on the concept of flexible compensation. Small group meetings modeled after the group meetings held with the random sample of employees (Event 5) will probably be the best method of informing and clarifying details of flexible compensation. The experience gained with the random sample of employees during the investigatory stage will be most helpful. Those employees who were involved in the sample groups can also be utilized as group leaders to explain the concept to their fellow employees.

Event 19: Once it is felt that employees have become familiar enough with flexible compensation to make competent
decisions, the educational phase can be completed. Feedback from small group meetings will indicate when this point is reached.

Event 20: Employees are permitted to select the compensation options which are best suited to their individual needs.

When Unions Are Involved

The previous discussion has made no mention of the procedure to be used when employees are represented by unions. Collective bargaining will create additional problems since unilateral decisions by management concerning compensation matters will most likely be contested by the union.

If there is a spirit of cooperation (supra, p. 99), collective bargaining should not be a deterrent to implementation of flexible compensation. In fact, the union could provide assistance since it has lines of communication with employees. Costing the various components may be somewhat less of a chore for firms engaged in collective bargaining since such firms will probably have considerable cost information already prepared on compensation for negotiation purposes.

Once corporate approval is given for a feasibility study, union officials should become involved in the planning study of flexible compensation. Sharing the results of preference data collected from the random sample of employees will make
both management and unions more responsive to the needs of employees. By restricting bargaining to those areas which employees value, the union can take credit for bargaining and management can provide a compensation program more likely to attract, hold, and motivate employees. Therefore, it would be difficult to visualize how the union's knowledge of employee compensation preferences could be damaging. Furthermore, involvement by the union in the planning stages can facilitate employee acceptance since they will be less likely to perceive flexible compensation as a ruse by management designed to somehow trick employees.

It may be advisable for management and union officials to agree upon the appointment of a qualified union member to serve as "project officer" for the union. The union's "project officer" for flexible compensation can serve as a liason officer between management and union officials to keep communications open and develop sensitivity toward each other's position and problems.

Summary

The preceding guidelines on how to implement flexible compensation are extremely broad and general. No attempt was made to develop specific instructions since it is unlikely that any two firms will ever have exactly the same problems. It is hoped that these general guidelines can be used as a starting point for those compensation managers who are
searching for ideas on how to implement such a program. If, out of criticism levelled at these guidelines, better plans are devised then the research has served its purpose.

Implications for Further Study

This paper is rife with implications for further study and research. While the problems listed by compensation practitioners appear to be surmountable on paper and in theory, it is still not known exactly how implementation of flexible compensation would proceed in actual practice. Will beautiful theory clash with ugly facts?

A definitive study of an actual case where flexible compensation is actually implemented would contribute greatly to the knowledge of flexible compensation. Research and study of an action on-going program would provide information on the ability to predict employee preferences, administrative problems, and costs. Of particular importance to compensation theory is the impact of flexible compensation upon the firm's ability to attract, hold, and motivate employees. Measuring the impact of flexible compensation upon employees will be the ultimate test of flexible compensation as a "reward for services rendered."
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I am asking you for help. As a point of departure for my dissertation at North Texas State University, I am asking the American Compensation Association members to assist in compiling data on flexible compensation for nonexempt employees. While several theoretical articles have appeared in recent months discussing this new concept of flexible compensation (also referred to as "cafeteria", "supermarket", "smorgasbord", or "individualized" plans), little is actually known as to its current status, especially in the area of nonexempt employees.

As professional practitioners, you are interested in staying current and abreast of all new concepts, theories, and practices in your field. I will, therefore, send you the results of this A.C.A. survey as a way of thanking you for taking some five or ten minutes to complete this questionnaire. And, despite its appearance, it is a brief questionnaire since you complete only three of the sections, depending upon your situation.

I promise you that the information you provide will be kept in strict confidence. At no time will any reference be made to your company unless you provide such permission at a later time.

It is felt that the results of this questionnaire portion alone will be a worthwhile contribution to knowledge. With your cooperation and help, we will both mutually benefit.

Thank you very much for completing the questionnaire and returning it in the enclosed, stamped envelope.

Sincerely,

Ben Tanksley
BT/tp
COMPANY DATA

How many nonexempt employees (per Fair Labor Standards Act) are employed by your company:
Less than 500 □ 500-999 □ 1000-5000 □ More than 5000 □

What percentage of your nonexempt employees are unionized? 0% □ less than 10% □ 10-30% □ 31-50% □ more than 50% □

How many unions represent your nonexempt employees? 0 □ 1 □ 2 □ 3 □ 4 or more □

Do you engage in multi-employer bargaining? yes □ no □

How many domestic plant sites are involved in your operations? 1 □ 2 □ 3 □ 4 or more □

To what industry does your firm belong?

FLEXIBLE COMPENSATION DATA

DEFINITION: For this study, flexible compensation is defined as any compensation program which permits the employee to select from the various benefits and cash a plan tailored to his own need, limited only by his total compensation and those statutory provisions pertaining to his wages. In other words, the employee selects compensation options he values by dividing his total compensation among the benefits offered.

IF you are CURRENTLY UTILIZING flexible compensation, please go to Section I.
IF you have INVESTIGATED OR ATTEMPTED flexible compensation, please go to Section II.
IF you have NOT investigated or considered flexible compensation, go to Section III.

SECTION I. For companies CURRENTLY UTILIZING flexible compensation for NONEXEMPT employees (otherwise see Section II or III):

A. Please check the areas in which your employees have flexibility as defined above:
   □ Retirement contributions □ Stock options □ Special vacation arrangements □ Company housing
   □ Company automobile □ Profit sharing □ Bonus plans □ Shorter working week
   □ Education allowance/assistance □ Medical benefits □ Life insurance □ Others (please specify)

B. What was the ONE major reason for installing flexible compensation?
   □ Attract employees □ Motivate employees □ Reduce turnover □ Prevent unionization □ Other (please specify)

C. What were the basic problems you encountered when you introduced flexible compensation?
   □ Legal please explain briefly
   □ Union please explain briefly
   □ Administrative please explain briefly
   □ Cost please explain briefly
D. Do you plan to expand your flexible compensation program? yes □ no □

E. Do you plan to discontinue flexible compensation? yes □ no □

F. What has been the reaction of your employees to flexible compensation?

G. If you had it to do all over again, would you still install flexible compensation? yes □ no □

Please go to Section IV.

SECTION II. For Firms which have INVESTIGATED □ or ATTEMPTED □ flexible compensation for NONEXEMPT employees but do not currently have flexible compensation (otherwise see Section III).

A. In what areas were you considering flexibility?

- □ Retirement contributions
- □ Stock options
- □ Special vacation arrangements
- □ Company housing
- □ Company automobile
- □ Profit sharing
- □ Bonus plans
- □ Shorter working week
- □ Education allowance/assistance
- □ Medical benefits
- □ Life insurance
- □ Others please specify

B. What was the ONE major reason for investigating or attempting flexible compensation?

- □ Attract employees
- □ Motivate employees
- □ Reduce turnover
- □ Prevent unionization
- □ Other please specify

C. What were the basic problems which have thus far prevented installation of flexible compensation?

- □ Legal please explain briefly
- □ Union please explain briefly
- □ Administrative please explain briefly
- □ Cost please explain briefly
- □ Other please explain briefly

D. Do you plan to utilize flexible compensation in the future? yes □ no □ If yes, when do you estimate that you will install flexible compensation?
E. Did you communicate with your employees concerning flexible compensation? yes □ no □ If yes, how and what was their reaction? 

Please go to Section IV.

SECTION III. For companies who have NOT INVESTIGATED OR CONSIDERED flexible compensation for their nonexempt employees:

A. Even though you have not seriously investigated or considered flexible compensation for your nonexempt employees, what would you anticipate as being the major problems should you attempt such an undertaking?

□ Legal please explain briefly

□ Union please explain briefly

□ Administrative please explain briefly

□ Cost please explain briefly

□ Other please explain briefly

B. Do you feel that your company may become involved with flexible compensation for nonexempt employees in the near future? yes □ no □

C. Which ONE of the following would you consider as being the major reason if and when your company were to install flexible compensation for its nonexempt employees?

□ Attract employees □ Prevent unionization

□ Motivate employees □ Other please specify

□ Reduce turnover

Please go to Section IV.

SECTION IV. Are you aware of any other company or individual who is involved with and studying flexible compensation?

<table>
<thead>
<tr>
<th>Their name</th>
<th>Company</th>
<th>Address</th>
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Please make any other comments or suggestions you would like to add.
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Brochures